79-628

Supreme Court, U. S.
FILED
OCT 15 1979
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-

CALIFORNIA ASSOCIATION OF UTILITY SHAREHOLDERS (a corporation),

Appellant,

v.

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA and JOHN E. BRYSON, VERNON L. STURGEON, RICHARD D. GRAVELLE, CLAIRE T. DEDRICK, and LEONARD M. GRIMES, JR., the members of said Public Utilities Commission; THE PACIFIC GAS AND ELECTRIC COMPANY, a corporation,

Appellees.

On Appeal From the Supreme Court of the State of California

JURISDICTIONAL STATEMENT

WILLIAM L. KNECHT
524 - 23rd Street
Oakland, California 94612

HOWARD C. ANDERSON
Dewey, Ballantine, Bushby,
Palmer & Wood
1775 Pennsylvania Avenue, N.W.
Washington, D.C. 20006
(202) 862-1050

Attorneys for Appellant
California Association of
Utility Shareholders

October 15, 1979

PRESS OF BYRON S. ADAMS PRINTING, INC., WASHINGTON, D. C.

INDEX

Page

OPINIONS BELOW 2

JURISDICTION 2

QUESTION PRESENTED 3

CONSTITUTIONAL AND STATUTORY PROVISIONS 4

STATEMENT OF THE CASE 4

Background 4

A large part of the population of California is dependent on PG&E for gas and electric service. The California Public Utilities Commission regulates PG&E without regard to attrition—the constant worsening, caused by inflation, of the ratio of earnings to plant investment—, thus driving the market price of common stock below book value. PG&E is required by law to expand to give service. Its sale of new stock below book value, continuous since 1973 and required by Commission action, confiscates the equity of stockholders in the Company.

Proceedings Below 6

Appellant proved steady attrition, causing *any* allowed rate of return to decline. This proof was not rebutted or even questioned. The Commission ignored it. On appeal, the Supreme Court of California ignored it. The Commission cited the controlling cases, *Bluefield* (262 U.S. 679) and *FPC* v. *Hope* (320 U.S. 591) but ignored the application of those cases to an inflationary period. When the yardstick is changing because of inflation (conservatively calculated at 6 percent), it is contemptuous of constitutional rights to legislate utility rates on the basis of a fictitious yardstick, yet the Commission did exactly that and was sustained by the California Court.

Page

The Appellant Has Standing 14

Appellant has standing to represent its members who are holders of PG&E common stock. The stockholders have standing; they suffer an injury wholly different and distinct from the injury suffered by the Company, because California law requires the Company to sell stock below book value using the stockholders' equity as bait to bring in new money.

The Question is Substantial 17

It is essential to the nation that gas and electric companies meet the needs of customers. Regulation which blindly ignores inflation is destroying the ability of PG&E and other utilities to raise funds to give service (which they are required by law to do) except to the extent that confiscation of stockholders' equity furnishes bait to attract new money. Confiscation violates the Constitution. Further, it is a device which has a short life. Sophisticated investors are leaving the market for PG&E common equity. The small investors are left to be confiscated.

Conclusion 21

This Court should save the situation by asserting jurisdiction and applying the teaching of *Bluefield* and *FPC* v. *Hope*. The Court need only remand the case to California with instructions to make due allowance for attrition.

CASES: Page

Allegheny Corp. v. Breswick & Co., 353 U.S. 151 (1957) 15

American Power & Light Co. v. SEC, 325 U.S. 385 (1945) 15

Atchison, Topeka & Santa Fe Railway v. Public Utilities Commission of California, 346 U.S. 346 (1953) 3

Bevel v. Sterkin, 66 Cal. PUC 286 (1966) 16

Bluefield Water Works & Improvement Co. v. Public Service Commission of West Virginia, 262 U.S. 679 (1923) 2, 7, 10, 11, 17, 19, 20, 21

California Water and Telephone Co. v. Public Utilities Commission of California, 51 Cal. 2d 478, 334 P. 2d 887, 27 PUR 3d 442 (1959) 16

Citizens Utilities Co. of California, 53 Cal. PUC 264, 4 PUR 3rd 97 (1954) 19

F.P.C. v. Hope Natural Gas Co., 320 U.S. 591 (1944)..11, 12, 17, 19, 20

Hope Natural Gas Co.; F.P.C. v., 320 U.S. 591 (1944) 11, 12, 17, 19, 20

Lake Erie & Western Railroad Co. v. Public Utilities Commission of Illinois, 249 U.S. 422 (1919) 2

Lande v. Napa Ranch, 30 Cal. RRC 704 (1927) 16

Lukrawka v. Spring Valley Water Co., 169 Cal. 318, 146 P. 640, PUR 1915 B 331 (1915) 16

Middlesex Water Co. v. Board of Public Utility Com'rs., 6 N.J. Misc. 51, 140 Atl. 254, PUR 1928 C 343, (N.J. Sup. Ct. 1928) 16

Napa Valley Electric Co. v. Railroad Commission of California, 251 U.S. 366 (1920) 3

Pacific Telephone & Telegraph, 80 Cal. PUC 599, 16 PUR 4th 384 (1976) 19

Page

People v. Western Airlines, Inc., 42 Cal. 2d 621, 268 P. 2d 723, (1954), appeal dismissed, 348 U.S. 859 (1954) 3

Sierra Club v. Morton, 405 U.S. 727 (1972) 15

Warth v. Seldin, 422 U.S. 490 (1975) 15

CONSTITUTIONS AND STATUTES:

United States Constitution:
Fourteenth Amendment 3, 4, 13

California Statutes:
Public Utilities Code of California § 451 .....4, 16

Federal Statutes:
28 U.S.C. § 1257 2
28 U.S.C. § 2103 3

MISCELLANEOUS:

Executive Office of the President, Office of Management and Budget, Mid-Session Review of the 1978 Budget, July 1, 1977 8

Saloman Brothers', Electric Utility Common Stock Data, September 4, 1979 18

Standard and Poor's Industry Surveys, Utilities, Electric, March 22, 1979, p. U-24 18

IN THE

Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-

CALIFORNIA ASSOCIATION OF UTILITY SHAREHOLDERS (a corporation),

Appellant,

v.

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA and JOHN E. BRYSON, VERNON L. STURGEON, RICHARD D. GRAVELLE, CLAIRE T. DEDRICK, and LEONARD M. GRIMES, JR., the members of said Public Utilities Commission; THE PACIFIC GAS AND ELECTRIC COMPANY, a corporation,

Appellees.

On Appeal From the Supreme Court of the State of California

JURISDICTIONAL STATEMENT

California Association of Utility Shareholders ("Appellant" or "Shareholders") appeals from an order of the Supreme Court of the State of California entered on July 19, 1979, upholding Decision No. 89316, dated September 6, 1978, and Decision No. 89654, dated November 9, 1978 (the "Commission Decisions"), of

the Public Utilities Commission of the State of California (the "Commission"). Notice of appeal was filed on October 9, 1979. Appellant submits this statement to show that the Supreme Court of the United States has jurisdiction of the appeal and should exercise its jurisdiction to determine the substantial federal question presented.

OPINIONS BELOW

The final judgment of the California Supreme Court (App. A), dated July 19, 1979, will not be reported. The judgment was entered without opinion, one justice dissenting from the Court's refusal to issue a writ of review. The Commission Decisions (App. B and App. C) are as yet unreported.

JURISDICTION

This appeal is brought to review a final judgment of the California Supreme Court upholding the Commission Decisions. Jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1257(2). The "statutes" whose validity is drawn in question are the Commission Decisions, which are statutes within the meaning of 28 U.S.C. § 1257(2): *Atchison, Topeka & Santa Fe Railway* v. *Public Utilities Commission of California,* 346 U.S. 346, 348 (1953); *Bluefield Water Works & Improvement Co.* v. *Public Service Commission of West Virginia,* 262 U.S. 679, 683 (1923); *Lake Erie & Western Railroad Co.* v. *Public Utilities Commission of Illinois,* 249 U.S. 422, 424 (1919).

The Supreme Court of California is the highest court of that state. The validity of the Commission Decisions was drawn in question in the California Supreme Court on the ground of their being repugnant

to the Constitution of the United States, and the decision of the California Supreme Court was in favor of their validity. Appellant asserted its rights under the Constitution of the United States in the Opening Brief (pp. 3 to 7), Reply Brief (p. 8), and Application for Rehearing and Reconsideration (e.g. p. 2, p. 25) filed with the Commission, and in its Petition for Writ of Review (pp. 4 to 7) and Memorandum of Points and Authorities (pages 11-14, 16-20, 22, 23-35) and Reply of Petitioner to Answer of Respondent (pp. 2-10, 21) filed with the California Supreme Court.

The judgment of the California Supreme Court is a final judicial decision on the merits of all issues including the federal questions raised in the state court review proceeding and before the Commission. *Napa Valley Electric Co.* v. *Railroad Commission of California,* 251 U.S. 366 (1920); *People* v. *Western Air Lines, Inc.,* 42 Cal. 2d 621, 630, 268 P. 2d 723, 728 (1954), *appeal dismissed,* 348 U.S. 859 (1954).

In the event that appeal is not considered the proper mode of review, Appellant requests that the papers on which the appeal is taken be regarded and acted upon as a petition for writ of certiorari pursuant to 28 U.S.C. § 2103.

QUESTION PRESENTED

Did the California Public Utilities Commission violate the Fourteenth Amendment by fixing rates of The Pacific Gas and Electric Company (the "Company") through the traditional method of establishing a relationship between rate base and earnings, but while ignoring the continuous inflation-caused deterioration which makes the declared relationship a fiction, so that shareholders of the Company, represented by Appel-

lant, have their property confiscated as the Company (acting under compulsion of California law to give service regardless of earnings) sells new stock below book value and deprives shareholders of their investment in the Company?

CONSTITUTIONAL AND STATUTORY PROVISIONS

The Fourteenth Amendment: . . . nor shall any State deprive any person of life, liberty or property, without due process of law. . . .

Section 451 of the Public Utilities Code of California:

> Every public utility shall furnish and maintain such adequate, efficient, just, and reasonable service, instrumentalities, equipment, and facilities, . . . as are necessary to promote the safety, health, comfort. and convenience of its patrons, employees, and the public.

STATEMENT OF THE CASE

Background

The Company supplies electric and natural gas service throughout most of northern and central California, an area with a population of over 9,000,000 people. Its sales to retail customers are regulated by the Commission. Its total assets exceed $9 billion. Its total operating revenues are approximately $3.8 billion and its total operating expenses are approximately $3.3 billion.

Appellant is a California membership corporation which represents shareholders of all major California public untilities and specifically, in this case, shareholders of the Company who are members of Appellant.

The Company has repeatedly filed applications with the Commission for permission to increase the rates charged by the Company, and the Commission has repeatedly made decisions which have allowed the Company to increase rates and rate of return only in amounts far less than as requested by the Company, without taking account of the fact that continuous and progressive deterioration in earnings, brought about principally by inflation, meant that the Company did not in fact receive the rate relief ostensibly allowed by the Commission. The Company did not, under such orders, receive an opportunity to earn the rates of return found by the Commission to be fair and reasonable and essential to the financial integrity of the Company. As a consequence the market price of the stock fell below book value during the first half of 1973 and has remained continuously below book value since that time.

The Company is required by California law to make whatever investment is required to serve the needs of the population in its operating areas, and this obligation is not qualified or limited by the fact that the investments may not produce reasonable revenues, nor by the fact that the Company does not have the funds to make such investments and can obtain such funds only by sales of securities on increasingly disadvantageous terms, including sales of common stock at prices per share less than the investment per share of existing stockholders. It is not possible to sell bond issues repeatedly without sales of common stock, since the Company's "equity ratio" is low and debt obligations become increasingly lower in quality with higher interest rates to the extent of eventually becoming unsaleable, unless sales of stock are made, at what-

ever price is obtainable in the marketplace, to preserve a tolerable debt-equity ratio.

As a result of the decisions of the Commission prescribing rates, which in fact will not yield even the inadequate rates of return authorized by the Commission, the Company has repeatedly met its legal obligation to serve California customers by selling common stock at less than book value [1] (i.e. less than the net investment per share), specifically with the purpose and effect of transferring to the new stockholders a portion of the investment of existing stockholders. The Commission has, by its repeated decisions, knowingly and intentionally deprived stockholders in the Company of substantial portions of their investment in the Company.

Proceedings Below

The Commission Decisions in this case resulted from applications filed by the Company on May 5, 1977. After extensive hearings, the Commission entered its

[1] *Every* sale of new stock by the Company since 1973 has been at prices below book value. Since that date up to and including the most recent issue, over 36 million shares have been sold below book, at discounts as high as 42%. The total dilution imposed on existing shareholders by such sales exceeds $270 million (Exh. 64, pp. 28-30, Exh. 65, Table 6). Forced sales of stock below book value cause confiscation. For example, if A and B form an enterprise and each contributes $10 for one share, the book value is $10 per share. If the enterprise needs additional capital and A and B reluctantly bring in a third investor at $7 for one share, the company has $27 in capital with three shares outstanding, each with a book value of $9 per share. A and B have lost $1 per share of their original investment. This is the heart of the problem. California law compels utility shareholders to accept this confiscation.

Decision on September 6, 1978 and on November 9, 1978 denied Shareholders' Application for Rehearing and Reconsideration. The Commission allowed a rate of return of 12.83 percent on equity and 9.5 percent on rate base. Shareholders believe that the rates of return found by the Commission in this case are far too low and are confiscatory based on the evidence before it. We do not believe that it is necessary for the Court to determine what the appropriate rate of return is in this case. This appeal is based on different grounds. It is based upon the complete failure of the Commission to make allowance for the continuous and obvious deterioration experienced by the Company in the conventional rate-base-revenue-expense formula which the Commission relied on to establish the rate of return.

The Commission's failure means that the authorized rate of return *can not* be earned as expenses, such as labor and the costs of new plant, increase faster than revenues. If the principles of *Bluefield* [2] and its progeny are still viable, there must be specific allowance made for this progressive deterioration in the formula for fixing rates during the expected life of the rates, which in California is now a minimum of two (2) years.

The Shareholders' point is that when 12.83 percent is the rate which the Commission found to be fair and reasonable, the Commission did not in fact authorize 12.83 percent rate of return because it failed even to acknowledge uncontradicted evidence which showed that any authorized rate of return on common equity

[2] *Bluefield Water Works & Improvements Co.* v. *Public Service Commission of West Virginia*, 262 U.S. 679 (1923).

was deteriorating (i.e. suffering attrition) at the rate of 0.16 percent per month.[3]

The facts regarding attrition and dilution were presented to the Commission in hearings on January 19, 1978 by Ross Cadenasso, who was called as a witness by Appellant. The witness' prepared direct testimony (Exhibit No. 64) and accompanying tables and charts (Exhibit No. 65) were sworn to and received in evidence (transcript page 1123) and the witness was cross-examined (transcript pages 1123-1129). The witness demonstrated that return on common equity had declined from 1976 to 1978 at 0.16 percent per month. He pointed out that inflation during the period had been close to 6 percent annually; that most economists were estimating inflation rates of at least that magnitude for the next several years; that Chairman Arthur Burns estimated the inflation rate in 1978 between 6 percent and 6½ percent; that President Carter's "Budget Review" as of September 26, 1977 estimated inflation at 6.3 percent in 1978 and 5.7 percent in 1979; that some economists believe that we may see a recurrence of double digit inflation by 1980 (Exhibit No. 64, pages 38-39). The witness estimated that the attrition rate for the period October, 1978 through March, 1980, with new rates in effect, would be 0.16 percent per month, assuming 6 percent inflation (Exhibit No. 64, page 39).

Mr. Cadenasso explained that the attrition factor could be employed by determining the mid-point of the

[3] 12.83 percent was the rate of return authorized for PG&E in the last previous general rate case and the Commission knew that PG&E had never been able to earn that allowance and that the price of its stock never approached book value thereafter.

period during which the new rates could be expected to be in effect; that the appropriate multiple of 0.16 percent per month should be added to the allowed (or "targeted") rate of return so that at the mid-point of the period the Company would have an opportunity to earn at the targeted rate of return (Exhibit No. 64, pages 39-40). The witness pointed out that if there is no adequate allowance for attrition, there is no way that the Company can actually earn the return found to be fair and reasonable by the Commission, because attrition will immediately start to erode the actual return (Exhibit No. 64, p. 42).[4]

Witness Cadenasso testified that since 1973 the Company had sold common stock each year; that 36.7 million shares of stock were sold, raising about $745 million for the Company; and that these 36.7 million shares of stock were sold at an aggregate of $279 million below their book value; that the Company had to sell 10 million more shares of common stock than it would have had to sell if it could have obtained book value (Exhibit No. 64 pages 28-29).

The witness concluded that an attrition allowance of 1.44 percent should be added to the allowed rate of return on equity, this being equivalent to nine months at 0.16% per month so that during the first nine months of the expected life of the new rates the earnings would be above the targeted rate and during the second nine months the earnings would be below the targeted rate. He recommended an allowed rate of return on equity

[4] The decline in the actual rate of return has caused a reduction in the market price, which is what an investor will pay for common stock of a utility. Mr. Cadenasso demonstrated that the decline in market price below book value became more severe after 1973 when inflation began accelerating.

in the range of 13.5 percent to 14 percent; with the addition of the attrition allowance of 1.44 percent this would require rates sufficient to produce initially a going rate in the range of 14.9 percent to 15.4 percent, decaying month by month, assuming inflation of only 6 percent per annum, so that the targeted rate of 13.5 to 14 percent might be achieved at the mid-point after nine months, and decaying further during the second half of the period to 1.44 percent below the targeted range (Exhibit No. 64, pages 40-41) so that the anticipated range, nine months after the mid-point, would be from 12.06 percent to 12.56 percent which of course is actually below the Commission's authorized return of 12.83 percent.

The witness testified that the objective of his approach and other approaches to the problem of attrition is the same, that is to achieve a targeted rate of return in a future period during which inflationary forces will steadily reduce earned rate of return (Exhibit No. 64, page 37).[5]

It is evident from the witness' testimony that the allowance for attrition, which he carefully computed at 0.16 percent per month based on 6 percent inflation, is entirely independent of the rate of return on equity which is found to be fair and reasonable; that rate of return might simply be regarded as "x" percent. Witness Cadenasso's "target" range on equity was 13½ to 14 percent, which is his value of "x". The Commission's rate for "x" was 12.83 percent.

The Commission, by legislative act, fixes rates for the future. Conventionally, as in this case, it develops

[5] The essence of *Bluefield*, 262 U.S. 679 (1923), was that shareholders were not adequately compensated during inflationary periods.

figures for the test year for revenue and for expenses and for rate base. To the extent that the Commission uses information which does not take account of deterioration because of inflation, then the figures are fictitious and in effect a hoax.

Witness Cadenasso was cross-examined by counsel for the Staff and by counsel for the Federal Executive Agencies (transcript pages 1123-1129). Neither cross-examiner asked any questions about attrition or took the slightest notice of the witness' testimony on that subject.

The Commission's Decision (No. 89316, dated September 6, 1979) is 107 pages in length, plus Appendices, plus a Dissent by Commissioner Symons and a Concurrence in the dissent by Commissioner Sturgeon. In its Opinion, it took no notice of the attrition evidence except to state on page 17b that "the California Association of Utility Shareholders believes that to achieve actual average earnings of 13½ percent to 14 percent will require a test year rate of return on average common stock equity of between 15.4 percent and 15.9 percent." The Commission simply recorded this "belief". It did not state the grounds of this belief, it did not analyze it, it did not express any interest in the subject or indicate any view of its own.

The Commission discussed rate of return at pages 17b to 21b of Decision No. 89316 (App. B hereto). It can be summarized as follows:

> The parties testified to different rates of return; the United States Supreme Court has established guidelines for the determination of just and reasonable rates of return, in *Bluefield* and *F.P.C.* v. *Hope Natural Gas Co.*, 320 U.S. 591 (1944); these

cases established that for a rate of return to be reasonable it should be sufficient to compensate investors for risks undertaken, to attract capital and to maintain the utility's financial integrity; *Hope* shows that the interest of the investor must be balanced against that of the consumer. [Nowhere in the Decision does the Commission attempt to demonstrate how these guidelines should be applied.] The Commission may exercise discretion.

The cost of debt and preferred stock is fixed and non-judgmental and the rate on equity is a major determinant of just and reasonable rates; measures adopted by the Commission, identified by the acronyms SAM, ECAC, PGA and as Regulatory Lag Plan are designed to allow the Company to maintain a reasonably constant cash flow; these measures must be viewed in the context of recent increases in inflation and upward trends in interest rates; these measures impact risk downward; otherwise a higher return might be warranted; in the balance, weighed against rising debt costs, a reduction in allowed return on equity is not warranted.

If the Company had vigorously pursued cogeneration efforts, more aggressively undertaken its commercial and industrial energy audit program and undertaken exhaustive review of repowering existing generating units as an option to building new capacity, and more aggressively promoted conservation, the Commission would be inclined to authorize a higher return of equity.

Based on the foregoing, there is no need to increase the allowed rate of return. The Commission found (App. B, page 21b) that a reasonable return on estimated 1978 total common equity is 12.83 percent; this results in 9.5 percent rate of return on rate base; this requires additional electric revenue of $39,188,000 and an additional gas revenue of $99,329,000.

In summary, attrition was ignored. The Commission continued to ignore attrition in dealing with Shareholders' Application for Rehearing and Reconsideration of Decision No. 89316. In its Application, dated October 4, 1978, Shareholders pointed out that the Decision on rate of return was confiscatory and unlawful and that it violates the Constitution of the United States (page 2), and that the Decision is repugnant to the Constitution of the United States and in particular the Fourteenth Amendment because it deprives shareholders of their property without due process of law in that it establishes a confiscatory rate of return and grants no provision for protection of that or any other return against attrition (pp. 24-25).

Decision No. 89654 (App. C), filed November 9, 1978, simply denied rehearing of Decision No. 89316.

Shareholders' Petition for Writ of Review to the Supreme Court of the State of California, dated December 5, 1978, clearly raised the issue of confiscation in violation of the Fourteenth Amendment because the uncontradicted evidence showed that any rate of return could be expected to decline at the rate of 0.16 percent per month and that the Commission's prescription of a rate of return, without allowing for or even making any findings on the fact of attrition, is a hoax (pages 3-7).

In its Answer to Shareholders' Petition to the Supreme Court of California, the Commission simply ignored the evidence on the issue of attrition. The Commission misstated the contention by saying ". . . the Commission had a number of recommendations before it. Not surprisingly the highest was that of the Shareholders' witness who recommended a range of 15.40

percent to 15.90 percent as a fair and reasonable return on common stock equity". Thus the Commission managed to misstate the Shareholders' recommendation for rate of return by including the recommended beginning-of-the-period allowance for attrition (1.44%) as part of the return allowance. The 1.44 percent was an attrition allowance computed on the basis of 0.16 percent for the estimated period from the effective date of new rates until the middle of the period for which they would be in effect. This allowance would decay month by month so that during the second half of the period the expected rate of return would correspondingly be *below* the target rate of return.

The Supreme Court of California disposed of the Petition for Writ of Review simply with two sentences: "Petition for Writ of Review Denied. Mosk, J. is of the opinion that the Petition should be granted".

Thus no California agency or court has ever deigned to discuss the contention of Shareholders that its constitutional rights and those of its members are violated when provision is not made for the impact of continuous inflation on rate of return. The Commission discussed the fuel cost and sales volume mechanisms (PGA, ECAC and SAM) and the Regulatory Lag Plan; see p. 12, supra) but not the problem of the continuing rise in general costs including interest rates.

THE APPELLANT HAS STANDING

Holders of common stock of the Company have suffered and will suffer injury as a result of the act of the Commission in establishing rates based on fictitious data, i.e. data respecting the relationship of revenue

less expenses to investment, when that data does not take account of existing and continuous attrition. Allegations of injury to members is sufficient for a justiciable case. *Warth* v. *Seldin,* 422 U.S. 490, 511 (1975); *Sierra Club* v. *Morton,* 405 U.S. 727, 735-741 (1972).

The interest of the stockholders who are members of Appellant is a substantial, constitutionally-protected interest, separate from the interest of the Company. When the stockholder has an interest distinct from the interest of the corporation, the stockholder has standing. *American Power and Light Company* v. *SEC,* 325 U.S. 385 (1945); *Allegheny Corp.* v. *Breswick & Co.,* 353 U.S. 151, 160 (1957). In this case, the stockholders are substantially damaged because the decisions of the Commission compel the Company to raise capital by selling additional stock below book value, thus transferring equity of shareholders to new purchasers. This injury is separate and distinct from the injury to the corporation. The Company is of course injured when it is granted an inadequate return, but the injury to shareholders resulting from the inevitable consequent sale of stock below book value does not injure the Company in the sense in which it injures the shareholders. When the Company sells stock below book value, its total net worth increases. It is better off as a result of the sale, although it has injured its existing shareholders. The shareholders find their equity partially confiscated; it is the bait which is offered to new investors.

It is well established, under California law, that the Company must find the money to build additional plant to serve customers in its operating area and that this obligation is absolute and is not limited by failure of the Commission to allow adequate earnings. *Lukrawka*

v. *Spring Valley Water Co.*, 169 Cal. 318, 146 P. 640, PUR 1915 B 331 (1915); *California Water and Telephone Co.* v. *Public Utilities Commission of California*, 51 Cal. 2d 478, 334 P. 2d 887, 895-6, 27 PUR 3d 442 (1959); *Bevel* v. *Sterkin*, 66 Cal. PUC 286 (1966); *Lande* v. *Napa Ranch*, 30 Cal. RRC 704 (1927); Section 451 Cal. Pub. Util. Code. The general law is in accord: *Middlesex Water Co.* v. *Board of Public Utility Com'rs.*, 6 N.J. Misc. 51, 140 Atl. 254, 256 PUR 1928 C 343, 347 (N.J. Sup. Ct. 1928), where the court said (140 Atl. at p. 256):

> It is rather an alarming proposition that a company, enjoying a franchise to furnish water to a municipality, in the performance of which task it must be considered that the lives, needs, health, and comfort of the inhabitants, and safety of property are involved, because all, more or less, are dependent upon an adequate supply of water, with adequate service, can successfully entrench itself against a compliance with the order of the board on the plea that the company has not the financial ability to furnish equipment for an adequate supply of water with adequate service for distribution. Palpably such an excuse cannot properly be permitted to prevail.

The constitutionally-protected interest of the shareholders represented by Appellant is infringed by the decisions of the Commission in a way which is distinct from the injury to the Company, in that the Commission's decisions compel involuntary confiscation of the investment of the shareholders.

THE QUESTION IS SUBSTANTIAL

The Commission acknowledges and purports to accept the guidelines established by this Court: "The United States Supreme Court has established certain guidelines for ratemaking agencies in its determination of the just and reasonable rate of return to be allowed public utilities" (citing and paraphrasing *Bluefield* and *Hope;* Decision No. 89316, App. B, page 17b). The right to the protection afforded by those cases is not contested. Nevertheless, the Commission ignores the issue of attrition. In its 107 page opinion it mentions it only in the sense of a recital (page 17b) that appellant "believes that to achieve actual average earnings of 13.5 percent to 14 percent will require a test year rate of return on average common stock equity of between 15.4 percent and 15.9 percent." Its counsel, defending the Commission's Decision in the California Supreme Court, ignored attrition and misstated the evidence, stating that Appellant's witness recommended a range of 15.40 percent to 15.90 percent as a fair and reasonable return on common stock equity, thus grossly and inexcusably burying the contention regarding attrition.

It is understandably difficult for this Court to deal with complicated issues of fact in rate cases. This is not a case in which the Court is faced with that problem. In this case, the proper and reasonable rate of return may be taken as "x". The issue is simply whether the Commission must take account of attrition, that is, whether in a situation of obvious and continuous inflation it can refuse to take cognizance of inflation in applying its rate-making formula. How the Commission must deal with attrition is not the issue. The correct allowance for attrition is not the issue.

At this stage we must assume that the California Supreme Court, on remand from this Court, would issue to the Commission instructions to take account of attrition and make a *bona fide* determination of a proper allowance.

Most, although not all, of the electric and gas distributing utilities of the United States and *their stockholders,* are directly affected by the issues in this case. Salomon Brothers' "Electric Utility Common Stock Data" for September 4, 1979, shows that 100 leading electric utilities had an average common stock market to book ratio of 88%. The median was 86%. Only 12 of the largest 100 companies had a market to book ratio of 100% or better and after considering underwriting costs, *only six* could raise new common stock equity today without partial confiscation of existing shareholder's equity.

The Company's ratio was 81%. The Company is in the process of offering nine million shares of new common stock (expected offering date of October 23, 1979) and the best current estimate of sales price is not more than 75% of book value.

At the same time, the production and distribution of energy is a matter of the greatest importance to the people of the United States now and will be of greater importance in the future.

The electric and gas utilities are growing industries with a need to attract huge amounts of new capital. Capital expenditures in 1979 are projected at $24 billion of which some $14 billion must be raised outside of the companies (Standard and Poor's Industry Surveys, Utilities, Electric (March 22, 1979) p. U-24).

Utilizing the projected 12% to 15% annual growth rates through 1987 (*id.*, p. U-25) produces the almost inconceivable amounts for the single year 1987 of $59 billion if growth is at 12% and $73 billion if growth is at 15% annually!

These utilities have a covenant relationship with the state. They must serve the reasonable needs of the public and in return the state must not preclude, either directly or indirectly, their opportunity to earn the authorized and reasonable rates of return.

To emphasize the Catch-22 nature of the problem, the California Commission may and has reduced the authorized rate of return for utilities for failure to provide adequate service, *Pacific Tel. & Tel.,* 80 Cal. PUC 599, 16 PUR 4th 384, 393 (1976), and has delayed institution of rates which would produce authorized rates of return pending improvements of service, *Citizens Utilities Co. of California,* 53 Cal. PUC 264, 4 PUR 3rd 97 (1954).

Appellant believes that shareholders and consumers alike will suffer irreparable damage if this Court fails to take jurisdiction of this case. Recently a number of cases have been presented to this Court by utility companies. In each instance the Court has declined to take jurisdiction without describing its reasons. Appellant believes that the securities of utility companies will have impaired marketability if the Court fails to give shareholders the protection of *Bluefield* and *Hope* when the issue is squarely raised.

Appellant further believes that the interest of consumers, especially in this energy-short age, are inextricably bound up with those of shareholders to maintain the economic viability of utility companies. Utility

companies that are unable to attract capital will be unable to meet consumers' demands for services.

Would a prospective investor put his money into a utility company if the company were required to disclose that there is no practical means of enforcing his right to a fair rate, and every likelihood of confiscation of a substantial portion of his investment? Appellant believes that persistent failure to give support to *Bluefield* and *Hope* will inevitably lead to a requirement of such a disclosure.

The responsibility of utilities to meet service requirements is a substantial distinguishing feature when comparing investor choices. An ordinary business operation has no externally imposed obligation to raise capital for expansion. It need not enter the money marketplace during times of great inflation. The utility must, and yet the Commission ignored the effect of inflation on the Company and on the shareholders. These utilities must attempt to obtain funds from investors on the basis of the free will decision of the investor. It is a substantial question worthy of the consideration of this Court, whether the interest at stake can be injured by the legislative act of the California Commission without permitting the investor to invoke the protection of the United States Constitution.

According to data submitted by the Shareholders to the Supreme Court of California (Petition for Writ of Review, p. 2) there were 337,000 accounts owning common and/or first preferred stock of the Company as of December 31, 1976 and of this total, 305,000 accounts owned 500 shares or less, representing an investment of $12,000 or less at current market prices.

The sophisticated investor has abandoned the market for PG&E common stock to others. Current owners of stock have undoubtedly made their investments on the protection they thought *Bluefield* described, e.g. ". . . the utility is protected against being compelled to serve for confiscatory rates . . ." *Bluefield,* at 694. These people deserve protection but if the Court will no longer protect them, they should know it. If utilities must disclose to potential investors that there is no constitutional protection against confiscation, can they raise the billions of dollars which will be necessary to satisfy consumers' demands for service?

CONCLUSION

For these reasons, this Court should note probable jurisdiction of this appeal.

Respectfully submitted,

WILLIAM L. KNECHT
524 - 23rd Street
Oakland, California 94612

HOWARD C. ANDERSON
Dewey, Ballantine, Bushby,
Palmer & Wood
1775 Pennsylvania Avenue, N.W.
Washington, D.C. 20006
(202) 862-1050

Attorneys for Appellant
California Association of
Utility Shareholders

October 15, 1979

79-628

Supreme Court, U.S.
FILED
OCT 15 1979
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-

CALIFORNIA ASSOCIATION OF UTILITY SHAREHOLDERS (a corporation),

Appellant,

v.

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA and JOHN E. BRYSON, VERNON L. STURGEON, RICHARD D. GRAVELLE, CLAIRE T. DEDRICK, and LEONARD M. GRIMES, JR., the members of said Public Utilities Commission; THE PACIFIC GAS AND ELECTRIC COMPANY, a corporation,

Appellees.

On Appeal From the Supreme Court of the State of California

APPENDIX TO JURISDICTIONAL STATEMENT

WILLIAM L. KNECHT
524 - 23rd Street
Oakland, California 94612

HOWARD C. ANDERSON
Dewey, Ballantine, Bushby,
Palmer & Wood
1775 Pennsylvania Avenue, N.W.
Washington, D.C. 20006
(202) 862-1050

Attorneys for Appellant
California Association of
Utility Shareholders

October 15, 1979

PRESS OF BYRON S. ADAMS PRINTING, INC., WASHINGTON, D. C.

INDEX

Page

APPENDIX A

Order Denying Writ of Review in the Supreme Court of the State of California, dated July 19, 1979 ..... 1a

APPENDIX B

Decision No. 89316 of the Public Utilities Commission of the State of California, dated September 6, 1978 ..... 1b

Dissent by Commissioner William Symons, Jr., dated September 11, 1978 .....110b

Concurrence in Dissent by Commissioner Vernon L. Sturgeon, dated September 6, 1978 .....119b

APPENDIX C

Decision No. 89654 of the Public Utilities Commission of the State of California, dated November 9, 1978 ..... 1c

APPENDIX D

Notice of Appeal to The Supreme Court of the State of California, dated October 5, 1979 ..... 1d

APPENDIX A

ORDER DENYING WRIT OF REVIEW

S.F. No. 23962

IN THE SUPREME COURT OF THE STATE OF CALIFORNIA

IN BANK

CALIFORNIA ASSOCIATION OF UTILITY SHAREHOLDERS, ETC.,
Petitioner,

v.

PUBLIC UTILITIES COMMISSION ET AL.

FILED JULY 19, 1979

Petition for writ of review DENIED.

Mosk, J., is of the opinion that the petition should be granted.

/ss/ BIRD
Chief Justice

APPENDIX B

Decision No. 89316 September 6, 1978

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application No. 57284

(Filed May 5, 1977; amended June 15, 1977)

Application of Pacific Gas and Electric Company for authority, among other things to increase its rates and charges for electric service.

(Electric)

Application No. 57285

(Filed May 5, 1977; amended June 15, 1977)

Application of Pacific Gas and Electric Company for authority, among other things to increase its rates and charges for gas service.

(Gas)

(Appearances are listed in Appendix A.)

INDEX

SUBJECT

	Page
Proceeding	2
General Information	6
Electric Service Area	8
Gas Service Area	9
Associated Companies	10
Results of Accounting Examination	14
Rate of Return	15
Results of Operation Summary and Adopted	20
Gas Department Results of Operation	23
Operating Revenues	23
Production (Cost of Gas) Expense	25
Gas Storage Expense	26
Gas Transmission Expense	27
Gas Distribution Expense	27
Customer Account Expense	29
Uncollectible Expense (Account 904)	29
Customer Services and Information Expense	30
Administrative and General Expenses	30
Franchise Requirements (Account 927)	31
Depreciation Expense	31
Rate Base	32

SUBJECT Continued

	Page
Electric Department Results of Operation	32
Operating Revenues	32
Production Expense	34
Transmission Expense	37
Distribution Expense	37
Customer Account Expense	38
Customer Services and Information Expense	38
Administrative and General Expenses	38
Franchise Expense	39
Depreciation Expense	39
Rate Base	39
Combined Gas and Electric Revenue Requirements Issues	40
Income Tax Expense	40
Operations Division Position	43
Finance Division	45
Discussion	45
Adjustments Proposed by UC and GSA	46
Ad Valorem Taxes (Gas and Electric)	47
The Effect of Article XIII A (Proposition 13)	47
Management Audit	48
PG&E's Conservation Efforts	48
The Staff's Position	50
The Energy Commission's Analysis	53
Position of the Environmental Defense Fund (EDF)	55
Position of TURN	56
City of Palo Alto and Southwest Gas	57

SUBJECT Continued

	Page
Position of UC	58
Discussion	58
Gas Rate Design	61
Gas Rate Design Proposals	61
Adopted Gas Rate Design	68
Electric Rate Design	78
Electric Rate Design Proposals	78
Adopted Electric Rates	88
Lifeline Rates	89
Medium and Large Light and Power Demand Charges	91
Small Light and Power	92
Agricultural and Medium and Large Light and Power Rates	94
Street Lighting Rates	94
Findings	97
Conclusions	100
Order	101
Appendix A (Appearances)	
Appendix B (Gas Rates)	
Appendix C (Electric Rates)	

OPINION

Proceeding

Pacific Gas and Electric Company (PG&E) filed Applications Nos. 57284 and 57285 on May 5, 1977 which, respectively, request authority to increase its rates and charges for electric and gas service. The rates were designed to increase gross operating electric revenues by approximately 7.3 percent, or $161,402,000 annually, and gross operating gas revenues by approximately 8.8 percent or $130,758,000 annually, on a 1978 test year basis. Because these applications were filed while hearings were in progress on PG&E's general electric and gas rate increase requests, Applications Nos. 55509 and 55510, the Environmental Defense Fund (EDF) filed, on June 28, 1977, a "Motion To Dismiss" upon the grounds that the applications were premature and incomplete in light of the potential outcome of the pending applications.[1] PG&E filed its response to EDF's motion on July 6, 1977.

By letter dated July 22, 1977 the Commission advised PG&E that:

> ". . . your above application numbers shall be deemed a Notice of Intention under the new Regulatory Lag Plan adopted by Commission Resolution No. A-4693 on July 6, 1977.
>
> "The Notice of Intention Required thereunder shall be deemed filed on July 25, 1977. However, because your application was filed prior to the adoption of the Plan, it shall be processed as the first major utility general rate proceeding under the Plan. A copy of the NOI is required to be served on all appearances in the last general rate case within five days after the filing. Under the circumstances in your case, a general statement

[1] EDF filed a "Supplemental Brief in Support of Motion To Dismiss" on July 22, 1977.

to all such appearances that the NOI has been deemed filed on July 25, 1977 will suffice. The 60-day period contemplated in the Plan shall commence on the filing date.

"The staff has advised that the standard requirement list has been complied with except for the required conservation material. Because of the two pending matters relating to conservation programs, such draft exhibits relating to conservation effectiveness shall be filed not later than December 1, 1977. The application for general rate increase required by the Plan shall be deemed filed on September 25, 1977 and shall bear the same numbers that the pending applications bear. Your notice of filing of the NOI should contain the information regarding the application filing."

In accordance with the Regulatory Lag Plan, a duly noticed prehearing conference was held at San Francisco on October 4, 1977 before Administrative Law Judge Gillanders.

On October 20, 1977, PG&E filed a petition requesting a partial gas rate increase. On November 21, 1977 the staff filed its response to PG&E's petition recommending denial of PG&E's motion.

Public witness hearings were noticed and held at Red Bluff on November 8, at Stockton on November 9, at Fresno on November 15, and at San Francisco on November 16, 1977.

On December 5, 1977, PG&E filed its response to the staff's recommendation. On December 7, 1977, TURN filed its response to PG&E's request for a partial increase in gas rates.

On December 20, 1977 we issued Decision No. 88262 in Application No. 57556, Application No. 57642, and Application No. 57284.[2] We ordered the following:

"1. Application No. 57556 is granted on the basis of the results of operation shown in Table 14-A of Exhibit 4 at a 9.5 percent rate of return. The amount thus authorized is $71,178,000 as a partial rate increase in Application No. 57284.

"2. For the 24-month period beginning January 1, 1978 all appropriate increases in base rates shall be offset by comparable dollar decreases in the Energy Cost Adjustment Clause (ECAC) rates and all appropriate reductions in rates shall be made.

"3. The monies collected in accordance with this order shall be subject to refund if found to be excessive by the final order in Application No. 57284.

"4. Pacific Gas and Electric Company (PG&E) shall maintain memorandum records to track the monthly increase in base revenue rates under the rate stabilization plan.

"5. PG&E shall apply any overcollection at a seven percent per annum interest rate against the ECAC balancing account.

"6. After the effective date of this order, PG&E is authorized to file the appropriate changes in base rates and ECAC rates as set forth in Appendix A attached

---

[2] Application No. 57556 for authority to implement a plan to stabilize electric rates and charges.

Application No. 57642 for authority to increase electric rates and charges in accordance with the energy cost adjustment clause.

Application No. 57284 for authority to increase rates and charges for electric service.

to this order. Such filing shall comply with General Order No. 96-A. The effective date of the revised schedules shall apply only to service rendered on and after the effective date thereof.

"7. Application No. 57642 is dismissed."

Applicant's presentation commenced on December 13, 1977. Hearings were held on 37 days between December 13, 1977 and April 12, 1978.

On April 11, 1978, TURN filed a "Petition for Proposed Report". On April 14, 1978, PG&E filed a response to TURN's petition. The petition is hereby denied.

On May 1, 1978, the presiding officer issued an order reopening the evidentiary portion for the limited purpose of receiving written and oral comments and evidence of his proposed mechanism to eliminate the revenue effect of differences between test year electric sales estimates and actual sales experience (ECAM). Hearing was held on May 24, 1978.

Concurrent opening briefs were filed on May 12, 1978. Reply briefs and written replies to the May 1, 1978 order were filed on May 29 and the matter resubmitted.

The record contains 4,350 pages of transcript in 43 volumes and 164 exhibits.

General Information

PG&E is fundamentally a combination gas and electric utility. It also provides public utility water distribution service in 11 communities and steam sales service in a limited area of San Francisco where steam is used primarily for heating and cooling. It represents today a combination of more than 450 predecessor companies.

PG&E's gas business began with the San Francisco Gas Company, which was organized in 1852 as the first gas

utility in the west and which introduced manufactured gas for lighting in 1854.

Electric service in the territory now served by PG&E commenced in 1879 when the California Electric Lighting Company began supplying series arc lighting service from a small central station in San Francisco, the first such station to be constructed in the nation.

Numerous competing gas and electric utilities were formed thereafter, both in San Francisco and in other cities and towns, with much duplication of facilities and intense rivalry for business. Out of uneconomic competitive wars came mergers and consolidations for greater efficiency and financial strength.

By 1896 the San Francisco Gas and Electric Company emerged with substantial but, at that time, expensive to operate steam electric generation capacity and an extensive manufactured gas system. In 1901 the California Gas and Electric Corporation was formed, consolidating several hydroelectric systems from which power was first brought into the Bay Area in that year. This company needed a wider market for its relatively low cost electric output.

PG&E was incorporated under California Law on October 10, 1905 to bring these two strong utilities together as the logical culmination of the long series of consolidations during half a century. This step gave San Francisco access to the lower cost hydroelectric power of the Sierra Nevada and provided steam capacity for firming the hydro generation.

For several years after its incorporation, PG&E operated as a holding company. In 1911, when it widened its direct ownership of utility properties, it became primarily an operating utility and has continued as such to the present time. The consolidation of San Joaquin Light and Power Corporation and Great Western Power Company into PG&E in 1930 and the merger with Coast Counties Gas

and Electric Company in 1954 brought PG&E's service territory essentially to its present limits.

Natural gas was introduced into the San Francisco Bay Area in 1929. California sources were adequate for the continuous growth in demand until 1950 when the first out-of-state gas was obtained from El Paso Natural Gas Company. Additional supplies from Alberta, Canada were introduced in 1961. To provide for peak periods and improve operating efficiencies, above ground and below ground storage capacity was constructed in several strategic areas commencing in 1948. Storage operations were commenced at the McDonald Island underground storage field in 1958 and at the Pleasant Creek underground storage field in 1960. The natural gas supplies from all the foregoing sources continued to be adequate to meet the needs of PG&E customers until the end of 1972, when supplies began to decline, initially as a result of a Federal Power Commission (FPC) mandate. This decline of total supplies available to PG&E is expected by PG&E to continue for the foreseeable future. In order to partially relieve this decline by providing additional withdrawal capacity to meet firm peak demands, the McDonald Island well and pipeline facilities were greatly expanded during the period 1973 through 1976.

The basic 500 kv transmission network, which provides electric interconnections between PG&E and the power agencies in the Pacific Northwest and in southern California, became operational in 1968. Consisting of over 1,000 circuit miles, the Pacific Northwest Interconnection provides increased efficiency in the pooling of power resources between regions and companies and makes possible the delivery of surplus northwest interruptible power into PG&E's service area and the entire State. The interconnection has been expanded to carry power generated by the nuclear units being constructed at Diablo Canyon.

On December 31, 1976, PG&E's outstanding capital stock consisted of 88,610,337 shares of common stock, 35,098,025

shares of preferred stock, and there were 337,070 common stock and preferred stockholders.

Electric Service Area

PG&E distributes electric energy in 47 central and northern California counties to provide service to customers in 201 incorporated cities, many more unincorporated communities, and extensive rural areas.

The PG&E's inland electric service area extends from Coffee Creek in northern Trinity County and Bieber in northern Shasta County to Lebec in southern Kern County. In the coastal area electric service is supplied from Orick in northern Humboldt County to Las Cruces in southern Santa Barbara County.

This service area includes the metropolitan, industrial, and residential areas surrounding San Francisco Bay, the industrial and residential areas of the major cities and communities, and most of the agricultural regions of the central and coastal valleys. As of December 31, 1976, PG&E served a total of approximately 3,087,000 electric customers in all classes of service, including residential, commercial, industrial, agricultural, street lighting, resale, and others.

PG&E presently distributes electricity for resale by the following incorporated cities:

Lodi
Lompoc
Ukiah
Santa Clara

PG&E provides transmission service to the following incorporated cities:

Palo Alto
Redding
Roseville
Santa Clara

Gas Service Area

PG&E distributes natural gas in 39 northern central California counties to provide service to customers in 188 incorporated cities, numerous unincorporated communities, and scattered rural areas. Transmission facilities are located in two additional counties.

In the central valley region, the gas service area begins south of Bakersfield and extends northward to Redding. Service is provided to coastal areas from King City northward to Eureka and Arcata. Additionally, gas is served to desert area customers from the Topcock-Milpitas transmission line in the eastern part of Kern County and in San Bernardino County.

The most concentrated distribution service is located in areas surrounding San Francisco Bay and to the cities in the Sacramento and San Joaquin Valleys. As of December 31, 1976 PG&E served a total of about 2,612,000 gas customers.

PG&E also supplies gas to the following utility companies for resale: California-Pacific Utilities Company (serving the city of Needles) and Southwest Gas Corporation (serving the cities of Barstow and Victorville).

Gas is also supplied by PG&E to the cities of Coalinga and Palo Alto which operate municipally owned gas distribution systems.

Associated Companies

PG&E's associated companies are:

1. Pacific Gas Transmission Company (PGT)
2. Pacific Transmission Supply Company (PTS)
3. Alberta Natural Gas Company Ltd. (ANG)
4. Alberta and Southern Gas Co. Ltd. (A&S)

5. Gas Lines, Inc. (Gas Lines)
6. Natural Gas Corporation of California (NGC)
7. Standard Pacific Gas Line Incorporated (StanPac)
8. Alaska California LNG Company
9. Pacific Gas LNG Terminal Company
10. Pacific Gas Marine Company

Pacific Gas Transmission Company owns and operates a natural gas transmission pipeline extending from the international boundary between Canada and the United States to the California border. The transmission company purchases natural gas from A&S, and transports the gas for sale at the California border to applicant. PGT also transports natural gas for Northwest Pipeline Corporation (NPC) for delivery to the Pacific Northwest.

The price of gas to applicant is based on a monthly cost-of-service tariff consisting of all operating expenses (including cost of purchased gas), depreciation, amortization, taxes (including applicable income taxes), and a return on rate base less charges to NPC for transportation service rendered and miscellaneous operating revenue.

Pacific Transmission Supply Company, a wholly owned subsidiary of PGT, was organized in December 1972 to carry out the Rocky Mountain Exploration Program. Some of the wells drilled as part of this program are considered to be potential commercial gas wells. PTS has applied to the FPC for authorization of sale of natural gas for resale in interstate commerce. PTS has entered into a gas purchase contract with PGT which provides for sale by PTS of its share of the production of natural gas in the Fontenelle Prospect in western Wyoming. The natural gas will be delivered to PGT based on a transportation and exchange agreement with NPC.

Alberta Natural Gas Company Ltd., a Canadian company, owns and operates a 36-inch pipeline from a point near Coleman, Alberta, to Kingsgate located on the British Columbia-Idaho border. It transports gas for both A&S and Westcoast Transmission Company Limited. It also owns and operates a liquid extraction plant near Cochrane, Alberta, which removes liquid hydrocarbons from the gas stream of A&S.

At December 31, 1976, PGT owned 44.87 percent of ANG's stock. Sales of stock have been made since October 17, 1972 to reduce PGT's ownership from 66⅔ percent to 45 percent in order to allow greater participation by the Canadians in the ownership of ANG. No further sales are currently contemplated.

ANG is subject to regulation by the National Energy Board (NEB) of Canada. This board has the power to issue certificates of public convenience and necessity for the construction of pipelines beyond the limits of a province, and to make orders with respect to all matters relating to traffic, tolls, or tariffs of such pipelines.

Alberta and Southern Gas Co. Ltd., a Canadian company, is engaged in purchasing gas from producers in numerous gas fields in Alberta, Canada. The gas is transported to the United States border by ANG for delivery to PGT at that point.

Prior to January 1, 1975, the amount charged for gas delivered each month was based on the Gas Sales Contract between A&S and PGT. The charge was the greater of the specified price in the contract or the actual cost of service of A&S. Since January 1, 1975, the export price of natural gas from Canada has been wholly controlled by the Canadian government and has exceeded both the specified price in the contract and the actual cost of service.

Gas Lines, Inc. leases excess pipeline capacity from PG&E and uses this pipeline space to transport gas for nonutility gas producers in California.

The charges which the company pays to PG&E for the use of its facilities are set forth in an agreement between the companies. The charges are based on the volume of gas transported by Gas Lines for nonutility customers.

Natural Gas Corporation of California, acquired by PG&E in 1954, owns producing gas wells and is engaged in exploration and development of natural gas lands. PG&E and NGC have agreed that NGC will conduct the gas exploration and development program for PG&E. The Commission, in Decision No. 80878 dated December 19, 1972 in Application No. 53118, authorized PG&E to advance $3,000,000 per year, for five years, for natural gas exploration with $1,500,000 of this amount to be charged to exploration and development expense and $1,500,000 to be added to investment in subsidiaries of PG&E. Benefits of the exploration program are to be passed back to PG&E as a reduction in PG&E's cost of gas.

PG&E has not included the annual $1,500,000 exploration and development expenses in its operating expenses for purposes of the current general rate case.

Standard Pacific Gas Line Incorporated is a California corporation which owns a pipeline. The company is a nonprofit private carrier of natural gas for the companies which own its stock, and is subject to the jurisdiction of the FPC. Applicant owns 85.7 percent (6/7) of the corporation's outstanding capital stock, and the remaining 14.3 percent (1/7) is held by Chevron USA (successor in interest to Standard Oil Company of California). The organization and management of the company are covered by an agreement executed in January 1961, which in essence provides that all costs and expenses are charged to the two stockholders in proportion to their interest in the company. For ratemaking purposes, 6/7 of StanPac's Plant-in-Service, Construction Work in Progress, and Materials and Supplies are included in rate base.

Liquefied Natural Gas Companies—Alaska California LNG Company, Pacific Gas Marine Company, and Pacific Gas LNG Terminal Company. PG&E formed three new wholly owned subsidiary corporations in February 1976 to facilitate its participation in joint liquefied natural gas (LNG) projects with Pacific Lighting Corporation (PLC). The three subsdiaries purchased equal partnership interests from PLC in three existing LNG projects.

PG&E's three LNG subsidiaries are now equal partners with three PLC subsidiaries in three partnership entities:

Pacific Alaska LNG Associates

Pacific Marine Associates

Western LNG Terminal Associates

Briefly, the division of LNG functions are:

(1) The purchase of natural gas and liquefaction of the gas for vessel transport.

(2) The transport of liquefied natural gas by special vessels.

(3) The receipt of the liquefied natural gas and regasification for transmission to consumers.

Results of Accounting Examination

Subject to its exceptions and recommendations,[3] it is the Finance Division's opinion that PG&E's accounting records and those of its regulated affiliated companies generally conform to the Uniform System of Accounts prescribed by the FPC and adopted by the California Public Utilities Commission, and that the accounting records of applicant's nonregulated domestic affiliated companies conform to generally accepted accounting principles.

[3] The exceptions and recommendations were incorporated into the staff's results of operation reports and will be discussed in following portions of this opinion dealing with rate base.

Rate of Return

Any rate of return determination necessarily requires the weighing of a number of economic intangibles which are difficult to measure by statistical comparisons. It devolves upon the judgment of the Commission, after weighing the evidence presented by all of the experts, to determine and set a fair and reasonable rate of return. (*Pac. Tel. & Tel. Co.* (1968) 69 CPUC 53.) It was the testimony of PG&E's expert that a 15.0 percent rate of return on common stock equity or 10.33 percent rate of return on rate base is needed to enable PG&E to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.

The Executive Agencies of the United States Government, using a discounted cash flow analysis, believe that 9.28 percent is a fair rate of return on total invested capital. The California Association of Utility Shareholders believes that to achieve actual average earnings of 13½ percent to 14 percent will require a test year rate of return on average common stock equity of between 15.4 percent and 15.9 percent.

The staff's expert recommended a rate of return of 9.50 percent on rate base, or approximately 12.77 percent return on common stock equity.

The United States Supreme Court has established certain guidelines for ratemaking agencies in its determination of the just and reasonable rate of return to be allowed a public utility. These are contained in two cases: *Bluefield Water Works and Improvement Company v. West Virginia Pub. Service Commission* (1923) 262 US 679, 67 L ed 1179, 43 S Ct 675 and *Federal Power Commission v Hope Natural Gas Co.* (1944) 320 US 591, 88 L ed 333, 64 S Ct 281. These cases establish that for a rate of return to be reasonable, it should be sufficient to allow a utility to compensate investors for risks undertaken, to attract capital, and overall to maintain its financial integrity. However,

the *Hope* case further stands for the proposition that the interests of the investor must be balanced against those of the consumer.

In this decision, we have followed these guidelines while at the same time realizing that, although many tests and refinements may be used by rate of return witnesses, each case must ultimately be determined after considering all the evidence and that the Commission may exercise a considerable amount of discretion in determining what is a fair and equitable rate of return. (*Pacific Tel. & Tel. Co. v P.U.C.* (1965) 62 Cal 2d 634, at 656-58; *Pacific Tel. & Tel. Co.* (1968) 69 CPUC 53; *General Tel. of California* (1969) 69 CPUC 601; *Southern California Edison Co.* (1971) 72 CPUC 282.)

In Decision No. 88262 dated December 20, 1977 in PG&E's electric department, Applications Nos. 57556, 57642, and 57284 we said:

> "There still remains to be decided the basis upon which interim relief will be granted. The last PG&E general rate case was based on a 1976 test year and authorized a 9.2 percent rate of return and a 12.83 percent return on equity. The staff here has recommended setting permanent rates for the 1978 test year of 9.5 percent, but recommends maintaining the presently authorized 9.2 percent rate of return if the Commission authorizes the requested plan, while acknowledging that the 9.2 percent reduces the presently authorized 12.83 percent return on equity to about 12 percent, while the 9.5 percent should keep the return on equity at about the presently authorized level. We have in the past stressed the significance of the rate of return based on rate base. A closer analysis indicates that this figure is basically derived from the cost of capital required by the utility. Since the cost of debt and preferred stock is fixed and non-judgmental, the cost of equity capital (the return on equity) is the determination we are required to make which requires the most subjective and judgmental evaluation. From this, we arithmetically determine the rate of return on rate base. Thus, it is clear that the rate on equity is the major determinant of the just and reasonable rates we are required to produce. Since the last authorized rate on equity will be essentially maintained by the staff's permanent recommendation of 9.5 percent return on rate base, and since we are desirous of maintaining the status quo regarding the return on equity, we shall adopt the 9.5 percent rate of return to produce that stabilization we are adopting in this decision."

On May 16, 1978, we issued interim Decision No. 88835 in Case No. 10261 an investigation on the Commission's own motion into a natural gas supply adjustment mechanism (SAM), for gas utilities. PG&E was named as one of the respondents. In Decision No. 88835 we found the following:

> "2. Gas margin was defined as gross revenue less cost of gas at the test year level adopted in the last general rate proceeding.
>
> "3. Small deviations in actual sales from adopted test year sales may result in significant deviations from adopted test year gas margins.
>
> "4. Traditional ratemaking treatment of supply and sales has proven to be an inadequate method of considering the fluctuations described in Finding 3. Offset treatment between general rate proceedings is required."
>
> • • •
>
> "11. A SAM will reduce the risk to utility shareholders. That reduction in risk should be considered by the Commission in setting a reasonable rate of return in rate proceedings."
>
> • • •

"13. Each gas utility should be authorized to implement a SAM balancing account effective on June 1, 1978. All gas utilities should be required to establish SAM balancing accounts on or before January 1, 1979."

In determining a fair return on common equity for these proceedings, we have considered the impact on risk derived from our adoption of Rate Stabilization and Energy Cost Adjustment Clause (ECAC) procedures for PG&E's electric department and the SAM and Purchased Gas Cost Adjustment Clause (PGA) for the gas department. We have also considered the fact that the Regulatory Lag Plan (applied to PG&E for the first time in these proceedings) worked extremely well.

These measures are designed to better allow PG&E to maintain a reasonably constant cash flow between general rate proceedings. These measures, however, must be viewed in the context of recent increases in inflation and upward trends in interest rates. But for these measures, it is likely that a higher return on common equity might be warranted to insure the financial health of the utility. Although, as mentioned, our innovative ratemaking measures impact risk downward, we do not find that in the balance (weighed against rising debt cost) a reduction in allowed return on equity is warranted.

Although we do not believe a downward rate of return adjustment based on inadequate conservation efforts is warranted at this time (as discussed in a following portion of this opinion), we think there are several areas of conservation endeavor and resource development in which PG&E has notably not been vigorous in its pursuit. Had PG&E vigorously pursued efforts to get cogeneration capacity on line, more aggressively undertaken its commercial and industrial energy audit program, and undertaken exhaustive review of repowering existing generating units as

a resource option to building new capacity, and more aggressively promoted conservation, we would be inclined to authorize a higher return on equity in this proceeding.

Based on the above, it is our judgment that there is no need to increase the allowed rate of return. Maintaining the previously allowed 12.83 percent return on equity and the 9.5 percent return on rate base will be sufficient to allow PG&E to compensate its investors for their risks, to attract capital, and to maintain its financial integrity. It is also our judgment that such return on equity fairly balances the interests of the investor and the consumer in that the consumer will be supplied with dependable service and adequate supplies of both gas and electricity while the investor receives adequate compensation. r. b.

Our above discussion on rate of return emphasizing the importance of return on equity should put utilities on notice that, when faced with potential increases in customer demand, there may not always be a financial benefit to favoring options, including new plant construction, that expand rate base. We believe this should encourage utilities to seriously consider other options for expanding or improving service. More aggressive facility maintenance and modification efforts, including repowering, can increase plant output and reliability. Load management through rates and devices can improve load curves and reduce increases in peak demand. We will order PG&E to review its repowering options (including all hydroelectric facilities) and facility maintenance and modification efforts to determine additional cost-effective options, and to report its findings within 180 days (as a compliance filing in these proceedings).

Cogeneration is another alternative, and we repeat that we expect PG&E to pursue its considerable cogeneration potential aggressively. We do not believe PG&E has satisfactorily pursued the development of cogeneration capacity.

In addition, many utility customers, especially institutional users (e.g., schools, hospitals, the telephone utilities) have or may be planning standby auxiliary power sources for emergency use or cogeneration facilities. PG&E should, within 180 days, review and catalog all such existing and potential sources in its service area and their availability to contribute power during PG&E's high demand periods. PG&E should address the economies, institutional arrangements, maintenance and fuel requirements, and possible cost-effective incentives necessary to enable it to call upon such auxiliary facilities as peaking capacity for its system and report to the Commission on its findings within 180 days.

Our direction to review these options, which include additional sources of supply, is made in keeping with our often repeated observation that conservation very often represents the most cost-effective alternative for meeting a given level of demand. Where it is cost-effective against other alternatives, conservation investment represents the most efficient use of California's available capital (with minimum environmental impact) and should be encouraged over new generation. The Environmental Defense Fund (EDF) in its report entitled, "Alternative Energy Systems for Pacific Gas and Electric Company: An Economic Analysis", submitted in this proceeding, has done an admirable job of demonstrating the potential benefits to both ratepayers and shareholders of investments in conservation, as opposed to new plant, under various ratemaking scenarios. Concurrently, with this opinion, we are issuing an OII to further explore these ideas and alternatives.

Finally, there has been considerable discussion in this proceeding on the need for long-range electricity supply and investment planning and for such planning to include alternative sources of energy, including energy conservation. We agree that this need exists, and, furthermore, will order PG&E to make such supply and construction plans looking forward a minimum of 20 years. PG&E shall also make such plans publicly available.

Results of Operation Summary and Adopted

PG&E and the Commissions staff have estimated PG&E's 1978 test year results of operation. Throughout the proceeding the staff accepted some of PG&E's expense estimates and PG&E accepted staff estimates. The following Table I shows the comparisons between final PG&E and staff estimates, for the gas department as well as our *adopted* test year results of operation. Tables II-A and II-B show the same comparisons and adopted results for the electric department.

Table I

Pacific Gas and Electric Company
Adopted Results
Gas Department

Results of Operation—Estimated Test Year 1978
(000's Omitted)

	Staff	Utility	Present Rates	Authorized Rates
Operating Revenues	$1,612,957[1]	$1,572,048[1]	$1,572,048	$1,671,377
Operating Expenses				
Total Production Expenses	827	827	827	827
Gas Cost				
Balancing Account	1,224,671	1,193,593	1,193,593	1,193,593
PGT Transport Cost	34,383	34,383	34,383	34,383
Gas Department Uses	(9,560)	(9,560)	(9,560)	(9,560)
Total	1,249,494	1,218,416	1,218,416	1,218,416
Storage Expense	2,827	2,957	2,869	2,869
Transmission Expenses	21,248	21,500	21,359	21,359
Distribution Expenses	53,700	56,240	55,872	55,872
Customer Account Expenses	35,354	35,589[2]	35,589	35,589
Uncollectibles	2,158	2,103	2,103	2,236
Customer Service and Informational Expense				
Base Program	3,793	3,793	3,793	3,793
Supplemental Conservation	7,474	7,474	7,474	7,474
Total	11,267	11,267	11,267	11,267
Load Management				
Rate Research	563	563	563	563
Admin. and Genl. Expenses	45,109	46,542	45,700	45,700
Franchise Requirements	9,439	9,200	9,200	9,781
Wage Adjustment	1,072	1,072	1,072	1,072
Subtotal	1,433,058	1,406,276	1,404,837	1,405,551
Depreciation	53,226	53,226	53,226	53,226
Taxes Other than on Income	44,806	44,806	44,806	44,806
State Corp. Franchise Tax	2,251	932[2]	1,062	9,937
Federal Income Tax	1,632	(4,762)[2]	(4,138)	38,937
Total Oper. Exp.	1,534,973	1,500,478	1,499,793	1,552,457
Net Oper. Rev. Adjusted	77,984	71,570	72,255	118,920
Rate Base	1,251,322	1,251,800	1,251,800	1,251,800
Rate of Return	6.23%	5.72%	5.77%	9.50%

[1] At present rates.

[2] Revised per p. 14, PG&E reply brief, income taxes recalculated.

Table II-A

Pacific Gas and Electric Company
Adopted Results
Electric Department

Results of Operation—Estimated Test Year 1978
(000's Omitted)

	Total Electric			
	Staff	Utility	Adopted	Authorized
Operating Revenues	$1,184,392[1]	$1,162,141[1]	$1,162,141[1]	$1,201,329
Operating Expenses				
Production Expense	101,249	103,289	101,808	101,808
Transmission Expense	17,147	17,193	17,193	17,193
Distribution Expenses	108,982	110,648	109,883	109,883
Customer Account Expenses	44,284	44,561[2]	44,561	44,561
Uncollectibles	2,203	2,162	2,162	2,234
Customer Services and Informational Expense				
Base Program	6,479	6,479	6,479	6,479
Supplemental Conservation	6,655	6,655	6,655	6,655
Total	13,134	13,134	13,134	13,134
Load Management				
Rate Research	6,716	6,716	6,716	6,716
Admin. and Genl. Expenses	102,055	104,618	103,018	103,018
Franchise Requirements	6,455	6,334	6,334	6,547
Wage Adjustment	2,189	2,189	2,189	2,189
Subtotal	404,414	410,844	406,998	407,283
Depreciation Expense	167,080	167,080	167,080	167,080
Taxes Other than on Income	120,855	121,070	121,070	121,070
State Corp. Franchise Tax	23,808	21,054[2]	21,400	24,901
Federal Income Tax	82,770	69,382[2]	71,062	88,055
Total Operating Expenses	798,927	789,430	787,609	808,389
Net Operating Revenues Adjusted	385,465	372,711	374,532	392,940
Rate Base	4,165,699	4,182,965	4,182,965	4,182,965
Rate of Return	9.25%	8.91%	8.95%	9.39%

[1] At present rates.

[2] Revised per p. 14, PG&E reply brief, income taxes recalculated.

Table II-B

Pacific Gas and Electric Company
Adopted Results
Electric Department

Results of Operation—Estimated Test Year 1978
(000's Omitted)

	Total Electric		CPUC Jurisdiction	
	Staff	Utility	Adopted	Authorized
Operating Revenues	$1,184,392[1]	$1,162,141[1]	$1,120,567	$1,159,755
Operating Expenses				
Production Expense	101,249	103,289	90,128	90,128
Transmission Expense	17,147	17,193	13,318	13,318
Distribution Expenses	108,982	110,648	109,423	109,423
Customer Account Expenses	44,284	44,561[2]	44,553	44,553
Uncollectibles	2,203	2,162	2,162	2,234
Customer Services and Informational Expense				
Base Program	6,479	6,479	6,479	6,479
Supplemental Conservation	6,655	6,655	6,655	6,655
Total	13,134	13,134	13,134	13,134
Load Management Rate Research	6,716	6,716	6,716	6,716
Admin. and Genl. Expenses	102,055	104,618	100,945	100,945
Franchise Requirements	6,455	6,334	6,250	6,464
Wage Adjustment	2,189	2,189	2,153	2,153
Subtotal	404,414	410,844	388,782	389,068
Depreciation Expense	167,080	167,080	162,270	162,270
Taxes Other than on Income	120,855	121,070	116,603	116,603
State Corp. Franchise Tax	23,808	21,054[2]	21,040	24,541
Federal Income Tax	82,770	69,382[2]	70,595	87,587
Total Operating Expenses	798,927	789,430	759,290	780,070
Net Operating Revenues Adjusted	385,465	372,711	361,277	379,685
Rate Base	4,165,699	4,182,965	3,996,682	3,996,682
Rate of Return	9.25%	8.91%	9.04%	9.50%

[1] At present rates.

[2] Revised per p. 14, PG&E reply brief, income taxes recalculated.

Gas Department Results of Operation

Operating Revenues

Revenue estimates are based on the level of rates which became effective July 12, 1977 in Decision No. 87585, a gas offset proceeding. PG&E's estimates have been adjusted to this rate level.

The staff's firm customer estimates were made by trending, considering recorded data through August 31, 1977.

The staff's estimates of customer sales by classes were developed utilizing PG&E's econometric model. The differences between the staff and PG&E involve the Consumer Price Index, Wholesale Price Index, marginal cost of gas, and nonagricultural employment in northern California. The staff estimates reflect recorded data for each variable through the first two quarters of 1977. PG&E's estimates are based on data through the third quarter of 1976.

The staff sales estimates reflect the effect of conservation. Recent conservation is reflected through the use of recorded data. For test year 1978, additional conservation has been reflected in specific adjustments due to appliances utilizing automatic ignition devices and for the effects of increased insulation because of revised building standards. In addition, residential consumption was correlated with a count of the number of residential buildings fitted with insulation.

The staff and utility requirement estimates show lower staff estimates for residential and commercial firm requirements and higher staff estimates for commercial and industrial interruptible requirements. The staff estimate reflects the transfer of a number of large customers from industrial interruptible to firm commercial schedules. As the staff has estimated a larger supply of available gas than PG&E, the staff's curtailment estimates are less. The staff estimates assume that all P-4 requirements will be satisfied and curtailment limited to P-5 customers. P-5

customers are Southern California Edison's Coolwater Plant and PG&E's Steam Electric Plants.

Staff adjustments representing higher gross revenues at both present and proposed rates are shown below:

	Present Rates	Proposed Rates
Gas Supply	$73,626,000	$79,285,000
Staff Estimate of Firm Requirements Resulting in More Gas Available for Interruptible Requirements	10,361,000	10,589,000
Energy Content of California Gas	1,097,000	1,181,000
Imputed Rent	79,000	79,000
Total	$85,163,000	$91,134,000

A witness for the General Services Administration (GSA) and the University of California (UC) testified that his estimate of PG&E's gas supply during 1978 was 776,030 M decatherms, or 5.86 percent higher than PG&E's estimate and 1.3 percent higher than the staff's estimate.

He made his projection of gas sales for residential, commercial, and industrial sales by using PG&E's year ended December 31, 1977, estimate of sales per customer times a different number of customers than PG&E estimated.

By adopting PG&E's sales estimate to residential customers, the staff's estimate of sales to commercial and industrial customers, and his estimate of gas supply, sales for steam electric purposes are increased almost to the staff estimate of 195,696 M decatherms. By this means, the gross revenue from gas sales can be increased. The differences between his estimate and those of PG&E and the staff are generally based on (1) different interpretations of regression analyses of recorded customers over the period of the last six years, (2) taking into account transfers from commercial class G-1 through G-9 schedules to the domestic class GS-1 through GS-9 schedules, and (3) the depressing effect of the PG&E econometric model on test year calculations of residential gas customers (households). His estimate of revenues from the gas department sales is $1,615,786,000. This is $87,992,000 more than PG&E's estimate and $2,829,000 more than the staff's estimate. We will adopt PG&E's gas supply and revenue estimate, which at present rates if $1,572,048,000 annually and $1,671,377,000 at the rates authorized herein.

Further, the staff's different projection of revenues is based on some assumptions which we are not sure will continue during the future period for which we are setting rates. First, the staff's estimate of residential demand is lower than PG&E's, and the staff assumes the gas which would otherwise be consumed by residential users will go to P-4 and P-5 customers, and the sales of additional gas to P-4 and P-5 customers would generate more revenue per therm sold. (That gas was priced by our rate design to be equivalent to alternative fossil fuel.) We believe the fluctuations in oil prices, particularly spot market oil purchase price, makes the staff's premise too speculative to rely on. If energy consumption and fuel choice trends and patterns were more solidified, we would be more comfortable with the staff's market relocation premise.

Likewise, we are not convinced that the estimate of UC and GSA is viable for ratemaking purposes. Given the tendency toward different usage patterns resulting from conservation consciousness and inverted gas rates, it is likely, in our opinion, that the witness for UC and GSA has not considered all the variables.

If we have misjudged in adopting our test year estimate of gas supply, the recent adoption of SAM (see earlier rate of return discussion) will insure that the utility's stock-

holders do not realize a windfall and that the ratepayers are protected.

Production (Cost of Gas) Expense

PG&E purchases 15.9 percent of its gas from northern California producers, 34.6 percent from El Paso Natural Gas Company (EPNG), which conveys gas for Texas and New Mexico producers, and 49.5 percent from PGT which imports gas from Canada.

The higher staff estimate of cost of gas is the result of its greater estimate of gas supplies. The greatest differences are in the California and El Paso volumes.

The staff estimate of energy content of California gas was obtained by trending the values for 1969 through 1976. The results are confirmed by the recorded monthly energy content of California gas for the first six months of 1977.

The staff assumed normal operations in which injections are equal to withdrawals.

PG&E and the staff estimate the cost of gas to be equal to the revenues embedded in rates to cover the cost of gas based on the sales estimate for Application No. 57285 and rates effective July 12, 1977. Embedded revenues represent that portion of the revenue received by PG&E which was allowed by the Commission to compensate for the cost of gas. This procedure was followed to coordinate the estimate of cost of gas for this proceeding with the gas cost balancing adjustment (GCBA) which will compensate for under- and overcollections.

P&E estimates test year gas cost to be $1,218,416,000, which is $31.1 million less than the staff's estimate. The primary reason for this difference is that the staff estimated 4.1 percent more gas available to PG&E. Because we have adopted PG&E's estimate of sales, it is consistent

to adopt the utility's estimate of gas expense (test year gas quantities available and revenues to be generated track).

Gas Storage Expense

PG&E's storage expense estimate for the test year exceeds the staff's by $130,000. This $130,000 difference results from different staff estimates for Accounts 816, 841, 834, and 845.

We believe PG&E's estimate of labor expense in Account 816, Wells Expense, and Account 845, Gas Holders, to be reasonable.

The staff used a trending approach to Accounts 841, Operation Labor and Expense, and 834, Compressor Station Equipment; PG&E based its estimate on 1976 recorded results. We believe for purposes of this proceeding that using an historical trend for these particular accounts is a better basis for projecting such expense for ratemaking purposes. Accordingly, we will adjust PG&E's estimate downward by $88,000, and adopt $2,869,000 for test year storage expense.

Gas Transmission Expense

PG&E's transmission expense estimate is $21.5 million. The staff proposes downward adjustments in this expense area totaling $252,000. PG&E's estimate for Account 853, Compressor Station Labor and Expense, should, as the staff proposes, be adjusted because the utility premised its estimate on 1976 recorded results. We adopted in the discussion on estimated revenues a conservative estimate of sales volumes. We think expense for this account may very likely be less than estimated by PG&E, given the specter of declining gas availability, and will adjust it by $141,000 as proposed by the staff.

The other proposed staff estimates for Accounts 850, 851, and 859 are not adopted because in our opinion PG&E has sufficiently justified the reasonableness of its estimates.

We adopt $21,359,000 for test year transmission expense.

Gas Distribution Expense

PG&E estimates test year gas distribution expense to be $56.2 million. The staff proposes an estimate of $2.5 million less.

The staff's estimate of Account 878, Removing and Resetting Meters, expense is $651,000 less than PG&E's. The staff trended cost for this activity on a unit per customer basis and arrived at a test year estimate of $2.58 per customer as a foundation for its estimate. Recorded unit cost per customer has fluctuated since 1972, and for both 1975 and 1976 it has remained at $2.70. PG&E's witness testified that labor costs have dropped since 1974 primarily because meter facilities were consolidated for efficiency, and that the transition period is over. We believe it is premature to accept the staff's trended estimate of this expense, given the stability during 1976 and 1977. The staff should review this expense area preparing for the next rate proceeding. At that time, it may be that a definite expense trend can be established.

The staff proposes that $91,000 less than PG&E's estimate be allowed for Account 878, Miscellaneous Meter Expense. PG&E based its estimate for 1978 test year expense on a combination of 1976 recorded results (for labor) and a 5-year average trend (for nonlabor). The staff considered the effects of automation occurring during 1977. We will adopt PG&E's estimate for this proceeding. If automation results in net expense savings for this account, the trend will be apparent in the future. At this time, we think the automation savings projected by the staff are still in the realm of a guess.

For Account 880, Other Expenses, the staff proposed an estimate $374,000 less than PG&E's original estimate. During the proceeding, PG&E agreed to the transfer of $239,000 in vacation pay accrual to its electric department. The remaining $135,000 difference is due to estimating methodology. We find PG&E's revised estimate to be reasonable.

In Decision No. 86281, Application No. 55509, we directed PG&E to study the feasibility of upgrading its maps and records procedures. The staff reviewed the results of the study, which concluded substantial savings could result from automating and centralization, and compared (on the electric side) PG&E's expense to Southern California Edison Company's. The conclusion reached by the staff is that PG&E can, if it implements the study's recommendations, save $1,154,000 in the test year (for both gas and electric departments). We are of the opinion PG&E should substantially implement the cost saving for its maps and records procedures. We believe it reasonable to adjust PG&E's estimate for Account 880, Maps and Records, by $1 million (total gas and electric) to reflect the savings it has the opportunity to realize in the future. Prorating this sum to the gas department results in an adjustment of $368,000. (A corresponding adjustment will be made to the electric department results of operations.)

The staff had a combined estimate for Accounts 886, 887, and 892 totaling $911,000 less than PG&E's. The primary difference was due to estimating approaches. For purposes of this proceeding, we find PG&E's estimates for those accounts to be reasonable. We believe the staff's estimate of savings resulting from cathodic protection to be overly optimistic.

We adopt $55,872,000 as reasonable for gas distribution expense.

Customer Account Expense

PG&E's revised estimate of test year expense is $35.8 million. The staff differed with PG&E's estimate primarily because the staff projected no increase in postal rates.

In its reply brief PG&E acknowledges that its revised estimate for this account includes a one-cent discount for presorting first class mail, although the new postal rates actually provide a two-cent discount. (Reply brief, p. 14.) We will adopt PG&E's estimate and correct for the change in the discount. We therefore conclude that an estimate of $35,589,000 is reasonable for customer account expense.

Uncollectible Expense (Account 904)

PG&E and the staff used the same uncollectibles factor. The difference in their respective estimates is due to different revenue estimates. We adopt PG&E's uncollectibles estimate of $2.1 million at present rates because it is consistent with our adopting PG&E's revenue estimate. At authorized rates we estimate an amount of $2,236,000.

Customer Services and Information Expense

Originally the staff took exception with PG&E's estimate for this expense area (which includes base programs and supplemental conservation programs) and estimated $7.3 million less expense. Ultimately, during the proceeding, the staff's Energy Conservation Team witness accepted PG&E's estimate. The issue of conservation expense was put into these proceedings by Decision No. 88272, Application No. 56845 (December 20, 1977), which abolished the conservation expense offset balancing account procedure.

We have concern about $4,750,000 estimated expense for implementing an "insulation incentive" program whereby customers who had insulated attics could receive utility installed water heater insulation blankets and conservation shower heads. Although we directed implementation

of that program by Decision No. 88551, Case No. 10032, rehearing has been granted and the program is deferred until our final resolution. However, PG&E's planned incentives programs relative to new ceiling insulation completions in the present application are different from those ordered in Decision No. 88551, and they should begin immediately. In the event that the planned programs are denied by any determination in Case No. 10032, the remainder of the $4.7 million should be applied to other conservation activities, in cooperation with the staff of the Energy Conservation Branch.

We adopt PG&E's estimate of $11.2 million as reasonable.

Administrative and General Expenses

PG&E's estimate for test year expense is $46.5 million. The staff's final estimate is $1.4 million less than PG&E's.

The staff's exceptions are with respect to Pension Expense, Account 926. It used a different estimating method for the number of new pension plan entrants, which would result in $747,000 less expense. Both the staff and PG&E extensively developed the record on this issue. We are of the opinion the utility did not fully support all of the estimated expense. However, we do not believe it reasonable to totally adopt the staff's estimate. We conclude that for this portion of Account 926 expense should be reduced by $500,000.

The remaining difference in this account totals $685,000 and relates to pension and benefits expense estimates associated with differences in direct labor expenses for various accounts. Because we have adopted some staff expense adjustments (which included labor expense), it is reasonable to concurrently adjust pension expense for consistency, and a reasonable basis to do so is to adopt half of the staff's proposed adjustment, or $342,000.

We conclude, based on the above discussion, that adopted test year administrative and general expenses should be $45.7 million.

Franchise Requirements (Account 927)

The staff and PG&E employ the same franchise expense factor, but the staff's estimate is $239,000 more than PG&E's because it is based on a higher gas department revenue estimate. Since we adopt PG&E's revenue estimate it is consistent and reasonable to adopt PG&E's franchise expense estimate of $9.2 million at present rates and $9,731,000 at authorized rates.

Depreciation Expense

Both PG&E and the staff estimated depreciation expense to be $53.2 million, which we will adopt.

Rate Base

The staff contends that the test year rate base should be $478,000 less than that proposed by PG&E. That difference is minuscule in view of a $1.2 billion rate base for the gas department.

The Finance Division as well as PG&E presented considerable testimony on the question of whether costs associated with a leasehold property known as Trico-Peny No. 3 (located in the Los Medanos gas field) were properly booked. PG&E contends that, if anything, the booked costs are too low and could be increased by $244,000. We believe that for purposes of this proceeding PG&E has demonstrated the reasonableness of the proposed test year rate base. The Finance Division may, of course, seek to better articulate the basis and foundation for this proposed adjustment in the next rate proceeding. In any event, as mentioned above, the effect of the staff's adjustment, if adopted, would be de minimis.

Electric Department Results of Operation

Operating Revenues

The staff estimates used recorded data up to July 1977, while PG&E utilized recorded data which ended in November 1976. The majority of the differences between the staff and PG&E results from the availability of current data to the staff.

Historical data on customers and sales from 1961 through July 1977 were analyzed by the staff. Economic considerations such as inflation, recession periods, drought, and the O.P.E.C. oil embargo were all given consideration. In this analysis, PG&E's econometric model was used by the staff with the later data than those used in the original PG&E estimate. Past trends of customer growth and usage patterns were given careful consideration. In the final result, a judgmental decision was made by the staff of customers and sales by customer accounts.

A witness for GSA and UC testified that his estimate of average number of customers twelve months ended December 31, 1978 was 9,531 more than PG&E's estimate and 10,996 more than the staff's estimate. He estimated that PG&E underestimated its sales by 2,363 M^3 kilowatt-hours and the staff underestimated by 1,026 M^3 kilowatt-hours. Consequently, it was his estimate that the test year revenue should be $29,723,000 more than PG&E estimated because of its underestimate of customers and sales. He stated the staff revenue should be increased by $19,842,000 due principally to its underestimate of revenues from the domestic and medium lighting and power classes of customers.

We are concerned about an inconsistency in our ratemaking process when the element of requiring conservation effort is a major consideration. If an electric utility achieves good conservation results between general rate proceedings, it is in a real sense penalized, given existing regulatory procedures. The problem is simple: if conservation results,

revenues decline, and the stockholder suffers. One possible solution is an Electric Conservation Adjustment Mechanism (ECAM), somewhat similar for SAM which we recently adopted for gas utilities; Decision No. 88835, Case No. 10261, dated May 16, 1978. Such a ratemaking procedure would allow for periodic rate adjustments, between adopted test year sales estimates, that would increase rates if sales declined, and reduce rates if sales exceeded the base (last Commission adopted test year) volumes. All other results of operations elements, such as expenses and rate base, would, when an adjustment is made, be held constant with last adopted test year levels. But we think it desirable to implement an ECAM procedure for electric utilities only after an investigation and full participation by all electric utilities and our staff. Although one day of hearing was devoted to the ECAM concept in those proceedings, we are of the opinion that the record was not sufficiently developed to implement an ongoing ECAM.

So, we are now back to our dilemma in this proceeding of selecting a test year sales volume on which to estimate revenues. PG&E's sales forecast is, in our opinion, more likely to be consistent with actual experience, given the impact conservation measures should have.

UC's witness compared the staff and PG&E estimates with recorded experience to arrive at his estimates. We do not think this approach is reliable for rate setting. It is based on data that are subject to distortion because of climatological irregularities. Also, it ignores changes in usage due to conservation efforts and rate design.

Production Expense

PG&E's estimate for total electric production expense is $103.3 million; the staff's is about $2 million less.

The staff proposes $417,000 less expense for Account 502, Steam Expense because PG&E projected 1976 results (a

drought year), whereas the staff applied a four-year average to represent a normal year. We believe the staff's approach will produce a more reflective test year estimate and will adopt it.

The staff also, in its estimate of total electric production expense (Account 507, Rents), arrived at $856,000 less expense as a result of investigating an oil storage contract with Urich Oil Company (Urich).

The staff takes exception to an agreement entered into in 1973 between the utility and Urich whereby Urich agreed to construct on its own property and operate four ½ million-barrel fuel storage tanks. The contract is for a 20-year period with termination only by mutual consent of both parties. Operating costs include depreciation and return on the actual cost of the tanks and actual costs on maintenance, operation, property taxes, and a number of other miscellaneous expenses. Each year Urich prepares a budget and this budget is approved by the utility. The contract provides for an audit by PG&E of all expenditures relating to construction, maintenance, or operation of the facilities.

The staff objects to PG&E's having entered into a 20-year contract when PG&E informed the staff that PG&E's needs were "short-term". Also, the staff contends that no formal economic study was made to justify the leasing of these tanks for 20 years. Further, the staff believes the company to be negligent in that it has not conducted any detailed audits to substantiate the original capital costs as well as the escalating annual costs. The staff recommends a decrease of $856,000 in the test year contract costs, and commencing January 1, 1980 all costs associated with the 1973 Urich lease should be excluded from operating expenses and treated as a below the line expense.

PG&E contends, primarily through its rebuttal witness, that this contract was a financially sound arrangement for PG&E; that PG&E's needs were well met by the 20-year

term of the contract; that the Urich facility is a valuable addition to PG&E's storage system and will remain so into the future; that the increase in anticipated expenses was primarily for capital changes in the facility; and that PG&E is presently auditing the Urich contract expense and will be able to recover from Urich any excessive charges that may have occurred in the past. The utility contends the staff adjustment is unreasonable and that the full test year estimated expenses of $4,294,000 be allowed for this facility. It further asks that the staff's recommended disallowance be rejected.

We have reviewed the evidence, particularly PG&E's rebuttal testimony, and are satisfied that the agreement was a necessary one. Since it was necessary, we find the 20-year contract the result of good faith negotiations by the parties and therefore reasonable. What we are *not* satisfied with is the utility's explanation as to why no audits of cost were ever made (PG&E's testimony is silent on this point). Further, we are not at all satisfied that the current audit would have ever been undertaken if our staff had not brought this matter to our attention. PG&E's contention that, five years after the audits should have been started, it will now be able to go back and collect the excess charges of the past is, at best, naive.

In summary, we conclude that the agreement was reasonable at the time it was entered into and therefore we reject the staff's recommendation that all of the Urich costs subsequent to January 1, 1980 be below the line. We conclude that PG&E has been negligent in not auditing the costs. We will accept the staff's estimate of the test year expense for this facility as being more representative than the utility's based on the results of the staff's investigation.

The staff's estimate for Account 501, Fuel—Other, is $208,000 less than PG&E's. The staff used a "normal-year burn", whereas PG&E used a 1976 drought-year burn. This

is an expense area where the utility will experience more incremental expense as more oil is handled. We will adopt the staff's estimate as more reflective of normal-year conditions.

We have reviewed carefully the staff's study on production expense. PG&E accepted many of the staff's original adjustments. The depth and scope of the study is impressive.

The staff's estimate for Account 540, Hydraulic Operations-Rent, is $163,000 less than PG&E's. The staff used a five-year average; PG&E used 1976 results, inflation adjusted. We find PG&E's estimate reasonable because it is more reflective of current conditions.

The staff estimated $300,000 less expense for maintaining generating facilities at Pittsburg Unit No. 7 (a relatively new plant), stating that PG&E's expense estimate was abnormally high compared to other units of similar vintage. We will not accept the staff's estimate, but we expect the staff to monitor closely the maintenance expense for that generating unit in the future, and report to us in the next proceeding on whether PG&E has succeeded in bringing its maintenance cost for this facility to a level comparable to its other more recently installed facilities.

PG&E's estimates for Accounts 511, 551, and 553 are reasonable because they project the most recent experience.

We adopt $101.808 million as test year total electric production expense.

Transmission Expense

PG&E's estimate for the transmission expense (total electric) is $17.2 million, which is only $36,000 more than the staff's estimate. The difference is in estimating procedures, and we conclude PG&E's estimate is reasonable. Originally the difference oetween the staff and PG&E was

larger, but was narrowed by agreement during the course of hearings.

Distribution Expense

PG&E's estimate for total electric distribution expense is $110.6 million. The staff's estimate is about $1.7 million less.

The staff estimated $1.2 million less (total gas and electric) expense on the assumption PG&E could automate and modernize its maps and records (Account 880). This issue is discussed in detail in the preceding section on gas distribution expense. We will adopt $632,000 less than PG&E's expense estimate for this item, which reflects an appropriate allocation of expense savings to the electric department of the total anticipated $1 million savings.

The staff's estimate for Account 588, Miscellaneous Distribution Expense, is $379,000 less than PG&E's estimate. The difference results from different estimating approaches for nonlabor expense. PG&E used 1976 results projected for the 1978 test year. We believe PG&E's estimate will be more reflective of test year conditions and will adopt it.

Finally, the staff estimated $133,000 less expense for Account 593, Tree Trimming. The staff's contention is that PG&E's estimate does not reflect cost savings resulting from recently available growth-retardant chemicals and the trend toward undergrounding. We will accept the staff's test year estimate for this activity as more representative of future expense.

We will adopt $109.883 as test year total expense for distribution expense.

Customer Account Expense

The staff proposed $277,000 less expense for mailing expense (see p. 14, reply brief). Originally PG&E estimated this expense to be $965,000 more than the staff's estimate; however, PG&E (in its reply brief) revised its estimate to reflect the actual amount of the recent postage increase to reflect the recent change to a two-cent presorting differential. We will adopt PG&E's estimates as corrected in the reply brief as being reasonable.

Customer Services and Information Expense

The staff analyzed PG&E's estimated expense for conservation and load management programs and found it reasonable. EDF, TURN, UC, and GSA questioned various specific conservation activities proposed by PG&E. Generally these parties took the position that PG&E should undertake more vigorous conservation activity. We will discuss generally PG&E's conservation activities in a following portion of this decision. We find that PG&E has justified its proposed test year conservation expense for the electric department.

Administrative General Expenses

PG&E's estimate for total company test year administrative and general expenses is $104.6 million. The staff's estimate is $2.6 million less.

The staff estimates different levels of pension expense, as discussed in the preceding section of the opinion on gas department administrative and general expense. Based on the rationale discussed earlier, we will adopt as reasonable $1.6 million less expense that PG&E estimated, or $103.0 million.

Franchise Expense

We have adopted PG&E's revenue estimate and consistent with that we will adopt the franchise expense estimate. The staff and PG&E generally agree on the same franchise rate to be applied to gross revenues. At authorized rates we adopt the sum of $6,547,000.

Depreciation Expense

PG&E's estimate of test year depreciation expense is reasonable. No party challenged PG&E's depreciation expense estimate after PG&E adopted the staff's estimate.

Rate Base

PG&E adopted many of the staff's proposed adjustments to rate base, as well as the staff's estimate of weighted test year additions.

The difference between PG&E's and the staff's rate base estimate is $17.3 million, relating to the inclusion in rate base of cooling ponds at Pittsburg Power Plant Unit No. 7.

The staff believes PG&E was negligent in its constructing of cooling ponds for Pittsburg Unit No. 7 in that the ponds proved inadequate for the purpose intended, as PG&E subsequently built cooling towers to replace the cooling ponds. The cooling ponds were initially constructed because the San Francisco Bay Area Air Pollution Control District would not approve the usual cooling tower approach. Pittsburg Unit No. 7 was the first instance where PG&E used cooling ponds. After the cooling ponds were found inadequate, the Air Pollution Control District allowed the construction of cooling towers. Although there were obviously design problems[4] with the cooling ponds, we are of the opinion that at the time PG&E's conduct was generally prudent. PG&E had no alternative but to attempt the untried cooling method. We believe the staff's proposed adjustment relies too heavily on hindsight, and we will not adopt it.

---

[4] The record indicates that PG&E in several instances provided the designer with erroneous design information. Ultimately, the designer and PG&E litigated in court for damages, suing each other, and the matter was settled without damages to either party.

Combined Gas and Electric Revenue Requirements Issues

Income Tax Expense

In this proceeding, as in the last PG&E rate case, there was considerable disagreement among the parties concerning methodologies which should be employed to estimate reasonable test year income tax expense. The Commission's Operations and Finance Divisions proposed different methodologies. TURN proposed that the Commission adopt the recommendations made by ALJ Coffey in his proposed report in Application No. 55509 et al., stating that the Commission's traditional method of computing ratemaking tax expenses is a "conglomeration of accounting fictions". We will discuss the positions of the parties. However, it is essential to this discussion to quote from Decision No. 89315, issued today in Applications Nos. 55509 and 55510, Phase II, wherein we address basically the same contentions and conflicting positions:

> "Arriving at an estimate of federal and state income tax expense for a future test year is one of the most complex and troublesome issues in ratemaking. A test year is an estimated results of operations, comprised of various ratemaking revenue, expense (including taxes) and rate base estimates, which is adopted by the Commission as a basis of determining prospective revenue requirement and the reasonableness of proposed rates. We anticipate the estimated test year components we adopt will reasonably approximate actual operating results. But given the multitude of variables in the real world of utility operation, we recognize, as does anyone who observes the ratemaking process, that projected test year results can never exactly correlate with actual experience. The income tax component of the results of operation is particularly sensitive to many variables. For example, unusual expenses unanticipated when the operating expense (non-tax) component is established will mean less tax liability, because more expense deductions will

be available to the utility. Likewise, higher than estimated revenues will mean a higher tax bill. And the situation gets more complex for energy utilities given the deferral of expense recovery for energy costs (Purchased Gas Adjustment and Energy Cost Adjustment balancing account expense recovery procedures). Interested parties have expressed the view that we should strictly allow for 'taxes as paid' when setting rates. Arriving at an adopted test year tax expense estimate that will reflect taxes 'as paid', or exactly correlate with actual expense during the prospective test year, is as difficult as estimating exactly the revenues to be realized by the utility.

"The ALJ's proposed report points out another complexity. In regulatory ratemaking the adopted income tax allowance depends on what types of expense deductions are or are not considered in arriving at the estimated income tax liability. Appendix B is a table (taken from the ALJ's proposed report) which illustrates the impact that such deductions can have on tax expense.

"The proposed report recommended that PG&E be ordered to reduce rates $56.5 million annually, and make refunds, on the basis that actual tax expense differed from the expense allowed in the Phase I decision. We are of the opinion that it would be unreasonable to adopt this recommendation, and we will discuss why. We appreciate the efforts of the interested parties who developed the record and made recommendations, which brings to our attention issues that should be fully explored and addressed. Ratemaking, to operate in the public interest, should be based on estimates that as accurately as possible reflect a reasonable allowance for income tax expense.

"If we were to adopt the recommendations put forth in the proposed report there could be a substantial

effect on post tax interest coverage and the utility's earnings. We adopted a reasonable rate of return and return on equity for PG&E in the Phase I decision which recognized a certain interest coverage. Further, the rates authorized (based on our authorized rate of return) were determined by our traditional methodology of calculating and estimating income tax expense. To unilaterally change the method used to estimate income tax expenses without considering the effect on post tax interest coverage and return on equity (in a proceeding where authorized rate of return could, if warranted, be adjusted) would not be fair or in the best interests of maintaining financially sound utilities. Therefore, Phase II of these proceedings is simply not the forum where we can make drastic changes in calculating income tax expense. In fact, a general rate proceeding involving only one utility is not the best forum in which to obtain the most fully developed record on such proposed sweeping policy changes. For that reason, we are today issuing Order Instituting Investigation No. 24, joining all major utilities as respondents, to consider recommendations similar to those presented in the proposed report, and other recommendations on how we should estimate income tax expense for ratemaking. We expect full participation by our staff divisions, the respondent utilities, consumer interest groups, and the financial community on these important policy issues. Whatever we adopt as policy upon completion of the investigation will be implemented in appropriate proceedings affecting each utility's rates. This procedure is, we again stress, adopted so that we do not play blindman's buff [sic], with possible adverse ramifications, on a less than adequate evidentiary record."

Having covered the general background on the complexity of ratemaking and income tax expense, and the reasons

for the issuance of OII No. 24, we will briefly discuss the positions of the parties.

At the request of ALJ Gillanders, the company prepared Exhibit 97, which set out its income tax liability for the test year. Following the receipt of this exhibit, there was testimony and argument regarding which of three methods should be used by the Commission in arriving at a tax payment figure for test year 1978: the traditional ratemaking method; the method recommended by ALJ Coffey in his proposed report for Phase II of PG&E's last rate case; and the method proposed by the Finance Division. The Commission staff differed in its recommendations, with the Operations Division recommending the traditional ratemaking method and the Finance Division recommending a different test year tax expense determination.

Operations Division Position

The Operations Division submits that one of the crucial differences between its tax treatment and that proposed by the Finance Division is the treatment of the Diablo Canyon Nuclear Facility (Diablo). In its results of operations study for test year 1978, the Operations Division eliminated all aspects [5] of Diablo on the premise that when it becomes operative (and can be included in rate base) there will be a special Commission proceeding (a "Diablo offset") to determine all of the expenses, fuel costs, effect on rate base because of the operation of this new and expensive facility. Thus current property taxes on Diablo, as

[5] In our Decision No. 86281, we proposed that all expenses of the applicant's Diablo Canyon Nuclear projects be excluded in the adopted test year and be considered in a separate proceeding. The Operations Division's staff results of operation in this proceeding has excluded all costs related to Diablo Canyon including interest deductions, ad valorem taxes both for book and as income tax deductions, and investment tax credit progress payments consistent with our prior Decision No. 86281. Because of the special circumstances involving Diablo Canyon, we will continue to abide by our policy as stated in Decision No. 86281.

an example, have been excluded in estimating 1978 results of operations (including income tax expense). However, the Finance Division tax calculations include the income tax effect of these property taxes because they presumably will be paid by PG&E during the test year. The Commission's current procedure provides that all ad valorem taxes that have been and will be capitalized associated with the Diablo projects, will be recorded in the proper plant accounts when Diablo is operational at the *net* amount, reflecting income tax expense effects for both federal and state income taxes (which reduces the book value of the plant that goes into rate base). Furthermore, at the time of inclusion of Diablo Canyon in rate base, the proper treatment of all investment tax credits, including progress payments, will be considered.

Certain expenses totaling $3.5 million not considered necessary and reasonable to utility operations have been eliminated by the staff in its expense estimates. Once excluded from the cost of service method of setting rates, these expenses become discretionary to the utility. Should the company go forward and make such an expenditure, it will have an effect on tax expense (as a deduction) of approximately half the expended amount. The ratepayer is protected because these items are funded one-half by the stockholders and one-half by the effect of the tax rate. The Operations Division believes that eliminating these dollars from operating expenses and then including them in the tax calculation results in taking them away from the company twice, once by disallowing the expenses and again through the tax calculation.

The Operations Division further points out that interest expense relating to construction work in progress has not been included in its tax calculations because the interest element of the Allowance for Funds Used During Construction (AFUDC) itself reflects under the current method discounting the interest paid by the tax effect. If the calculation is made as suggested by the Finance Division, a

gross calculation method would be used and the AFUDC and ultimately the book value of plant would actually be increased by excluding the discounting tax effect attributable to the interest portion of the AFUDC.

Although the Operations Division presented testimony and other examples to support its method, we do not believe it is necessary to extend this discussion.

Finance Division

The Finance Division recommends, as it did in Phase II of PG&E's Applications Nos. 55509 and 55510, that the Commission revise the method of estimating income taxes for ratemaking purposes to reflect as nearly as possible the company's actual tax liability for the test year.

The Finance Division generally proposes the following with respect to determining test year income tax expense:

1. That the Commission include property taxes paid on plant under construction as an expense tax deduction to compute test year income tax expense.

2. That the Commission cease the practice of not including as an expense deduction for determining income taxes various expenses that are disallowed by the Commission for ratemaking purposes.

3. That interest expense on construction work in progress, or AFUDC, be considered as test year expense for the purpose of calculating income tax liability.

Discussion

We believe that the above summation of the different proposed methodologies for calculating test year tax expense illustrates the complexity of this general issue. For example, the Operations Division approach (which we have traditionally applied) considers the tax expense of interest

during construction and property taxes when plant (such as Diablo) is placed in service. The plant cost is "netted out" or reduced to account for such tax effects. Accordingly, the ratepayer ultimately receives benefit of such tax deductions. Whereas, the Finance Division approach is to consider such tax effect in a particular test year. There is merit to both points of view, which is why we find it in the public interest to fully explore such issues in OII No. 24. In that forum we want and expect vigorous participation by all major utilities, various staff divisions, consumer interest groups, and the financial community. These important ratemaking policy issues deserve no less than such an extensive examination.

Accordingly, for purposes of this proceeding, we will apply our traditional methodology, as proposed by the Operations Division, to calculate estimated test year federal and state income tax expenses.

Also, consistent with our traditional methodology, we find it is reasonable for purposes of this proceeding, to apply the statutory federal and state tax rates for the tax expense components of the net-to-gross multiplier.

Adjustments Proposed by UC and GSA

UC and GSA proposed two adjustments, one to rate base and the other operating expense.

The UC-GSA witness recommends that $17.4 million or 10 percent of gas and electric department operating and maintenance expenses be disallowed until "Management surveys are designed, approved and conducted and the recommendations implemented" (Exhibit 56, p. 7). He based his recommendation on a PG&E sponsored study on PG&E's Pittsburg Unit No. 7 generating plant. The cross-examination of UC-GSA's witness shows that he relied on a very localized study and simple inductive analysis to conclude what may be wrong at one facility is wrong at all. We share the witness' concern about expense at Pittsburg

Unit No. 7 (see our earlier discussion on electric production expense), but conclude his recommendation for a total company adjustment is not supported by evidence and we will not accept it.

UC-GSA's witness also recommended reducing PG&E's rate base by $14.3 million, the depreciated value of PG&E's Humboldt Bay Nuclear Power Plant, as well as associate expenses and working capital for the plant. His rationale is that the Humboldt plant is not operational and may not be operational in the foreseeable future. The staff and PG&E included the Humboldt plant in their test year rate base and expense estimates. The Federal Nuclear Regulatory Commission (NRC) is presently studying seismic conditions at the Humboldt site, and that agency will decide the future of the facility. We think it is premature to make an adjustment. If we adopted UC-GSA's recommendation, we would be prejudging the NRC. The Humboldt facility situation should be monitored closely, and in the next rate proceeding hopefully definitive information on its future, as far as the NRC is concerned, will be available.

Ad Valorem Taxes (Gas and Electric)

The only difference between PG&E and the staff for pre-adoption of Article XIII A of the California Constitution (Proposition 13) property tax expense is the result of the staff's proposed exclusion of cooling ponds at Pittsburg Unit No. 7 from rate base (electric). Since we did not adopt the staff's adjustment, we accordingly find PG&E's property tax estimate reasonable. The staff took no exception with PG&E's gas department estimate and we will adopt it.

The Effect of Article XIII A (Proposition 13)

The evidentiary record in these proceedings did not address the ramifications of recently adopted Article XIII A

of the California Constitution. PG&E, in accordance with our suggestion in OII 19, has filed Advice Letter Nos. 1006-G and 687-E which proposes to reduce gas rates by $17.74 million and electric rates by $43.876 million. PG&E has also established a "tax initiative balancing account".

We are not going to change the estimate of ad valorem tax expense contained in the record, and we will not change the base rates authorized herein. However, we find that it is reasonable to require PG&E to make the rate reductions set forth in Advice Letter Nos. 1006-G and 687-E to go into effect concurrently with the increase in base rates authorized herein. In this manner we insure the return to California ratepayers of their share of Article XIII A actual tax savings realized by PG&E.

Management Audit

In a previous section of this decision, under Electric Production Expenses, we have discussed the staff's studies and conclusions relative to the adjustment proposed for the Urich contract. We have taken the effort to describe in detail this adjustment, for we believe it illustrates the pressing need of monitoring the efficiency of the utilities we regulate. If we are to be more than a rubber stamp, translating cost increases into rate increases, we must scrutinize and exercise our investigatory ingenuity to insure utilities operate productively and efficiently. Our staff in this proceeding anticipated this need and has recommended that an operational and management audit of PG&E be made. We would like to make clear that, with the exception of PG&E's failing to audit the Urich costs, we have no preconceived notions on PG&E's efficiency and productivity. We believe, however, it is necessary that the company precisely examine its efficiency and demonstrate to us that it is attempting to improve its efficiency and reduce costs. A management and operational audit by an independent consultant may accomplish this result. Our staff should supervise this audit and we caution it to devise

specific areas of inquiry that will maximize the benefits of such an audit, for we think a comprehensive management audit would very possibly be a waste of resources. When our staff has identified the areas of inquiry to be covered by a management and operational audit, it shall report its recommendations to the Commission for approval before the audit is contracted for and commenced.

PG&E's Conservation Efforts

In earlier portions of this opinion we determined that PG&E's estimated test year conservation expense was reasonable, although $4.7 million of the rates authorized herein is subject to redirection in the event the insulation customer incentive programs are not approved on rehearing.

PG&E's plans for its 1978 energy conservation activities were presented in Exhibit 31. Table 1 of Exhibit 31 shows the following:

Summary of Estimated Conservation Activity Expenses for 1978

	Estimated 1978 Expenses (000's)		
Energy Conservation Programs	Base	Supplemental	Total
Insulation	$ 947	$ 6,133	$ 7,080
Appliances and Devices	1,534	1,893	3,427
Homes	562	515	1,077
Commercial-Industrial-Agricultural	2,016	2,555	4,571
Solar	645•	964	1,609
General	1,735	2,069	3,804
Subtotal—Programs	$ 7,439	$14,129	$21,568
Other Conservation Activities			
Load Management	$ 668	$ 7,279	$ 7,947
Research and Development	455	0	455
PG&E General Office Departments	2,784	••	2,784
Subtotal—Other	$ 3,907	$ 7,279	$11,186
Total Conservation Expenses	$11,346	$21,408	$32,754

• Includes solar R&D.

•• Included in individual programs.

PG&E expects that its energy conservation programs will save customers about 2.434 billion kwh and 946 million therms on a life-cycle basis.

The Staff's Position

The staff, during these proceedings, ultimately accepted as reasonable PG&E's test year budget for conservation.

The staff witness' analysis indicates that PG&E's Exhibit 31 conservation programs are cost-effective. However, the staff recommends the following modifications to achieve additional cost-effective conservation. The utility should develop an effective program to insulate residential rental property and commercial buildings. The appliances and devices programs should be expanded to include wholesalers, contractors, and commercial and agricultural sales. The customer incentive programs should be expanded to include public buildings other than schools. Solar involvement should be limited to domestic water heating guarantee arrangements, and distribution of tax, product quality, and financing information. PG&E should publish and distribute information on the availability, use, and guarantee of solar equipment. PG&E should develop a program to dispose of energy inefficient appliances in conjunction with any program to encourage sales of energy efficient appliances. The devices program to sell water heater blankets should be changed to provide blankets and shower heads for a $25 maximum installed per customer utility cost to customers with R-19 attic insulation pursuant to Decision No. 88551. The staff recommends $4,750,000 of the conservation budget be used for this program; $850,000 of this amount should be reallocated from the $964,000 requested for supplemental solar programs. The homes point system should be revised to exclude optional home appliances. Publicity for CIA awards should be limited to trade media, and expenses for banquets should not be charged to ratepayers. CIA awareness efforts should be increased. PG&E should in-

crease the use of direct customer contact in lieu of advertising to provide customer information on conservation. PG&E should explain in detail in its March 31, 1979 conservation report the benefits it receives from Electric Power Research Institute and American Gas Association research projects. PG&E should work to develop market research methods that accurately measure conservation savings. PG&E should have between 80 and 86 full-time commercial and industrial auditors by the end of 1978. PG&E should provide a bill insert describing relative energy efficiency of different refrigerator and freezer models. PG&E should amend Rule No. 14.1, Prohibition and Curtailment Provisions, to restrict the use of pool pumps and filters to off-peak periods. The staff recommends that the Exhibit 31 programs be ordered with these modifications.

The staff also recommends that $7,279,000 be approved for load management expenses. Because of the experimental nature of the programs and the large sum of money involved, the staff recommends that PG&E be ordered to report in its forthcoming annual December conservation report the results of its load management experiments, including any benefits such as decisions to forego new plant construction.

The staff believes PG&E's energy savings goals, efforts, and accomplishments are inadequate. PG&E's actual and projected energy savings are, according to the staff, minimal. It projects 1.31 percent electric and 2.39 percent gas savings in test year 1978 due to residual benefits from 1976 and 1977 and new 1978 programs. Savings will be 4.4 percent of electric and 7.8 percent of firm gas sales by 1987. The staff submits that these are savings partially attributable to PG&E's Conservation and Services Department setting overly modest goals. For example, the actual and projected savings for electric use for 1976, 1977, and 1978 are .42 percent, .38 percent, and .65 percent, respectively; the gas savings are .35 percent, .88 percent, and 1.06 percent.

The modesty of these actual and projected savings becomes apparent when one compares them with the 10 to 20 percent indicated potential savings for the commercial and industrial sector. On a per customer basis, PG&E's conservation expenditures are lowest of the three major gas and electric utilities. One method the staff used to measure the effectiveness of the utility's conservation efforts is a yes and no checklist of energy conservation activities. PG&E's performance was unsatisfactory in the five most important areas on the list: CI audits, residential rental property insulation, provision of information on energy efficient appliances to customers, cogeneration, and load management. As noted above, PG&E's projected savings for CI audits are far below potential savings for commercial and industrial customers. Nonetheless, conservation attributable to CI audits has been limited because of a lack of personnel and the utility's lack of interest in expending the audit program. PG&E failed to develop an effective residential rental property insulation program. The checklist in Applications Nos. 55509 and 55510 also indicated a failure to develop an effective residential rental property insulation program.

According to the staff, PG&E has not established goals for using existing cogeneration potential. A staff witness testified that this failure was especially crucial in the evaluation of PG&E's conservation programs. Cogeneration is important because it can reduce the utilities' load obligation, thereby reducing its need to construct new generating capacity and its use of fossil fuels. None of the cogeneration projects reported under consideration in Applications Nos. 55509 and 55510 has come on line, and the reported potential under consideration in this application has declined in the interim between the two rate cases.

The staff believes PG&E has not identified its customers' nonessential uses for load management purposes or established long-term load management goals by class. If PG&E were aware of customers' nonessential uses then it could

manage its load by requesting customers to reduce or shift consumption for these uses.

The staff thinks that perhaps one reason for PG&E's performances is its apparent dependence on the Commission and its staff to determine how it should cost-effectively spend conservation dollars. Counsel for PG&E extensively questioned Commission witnesses as to whether they had ascertained reasonable methods to encourage residential rental insulation, floor insulation, storm windows, cogeneration, disposal of inefficient appliances, compile data on energy inefficient appliances, and so forth. According to the staff, it is PG&E's obligation to determine through discussion with the staff and its own studies, prior to hearings on the evaluation of its conservation efforts, which conservation programs are cost-effective and worthwhile.

The staff's critique of PG&E's 1977 conservation efforts, as summarized above, basically goes to the failure of PG&E to implement on an extensive basis its supplemental conservation programs in 1977.

According to the staff, the Commission has put PG&E on notice that it will consider the vigor, imagination, and effectiveness of its conservation activities in arriving at an appropriate rate of return. The staff submits that PG&E's vigor, imagination, and effectiveness are inadequate. Therefore, in addition to the above-outlined recommendations, the staff's Energy Conservation Team recommends a .05 percent rate of return reduction. In addition, the Legal Division recommends that an OII be issued to investigate the establishment of conservation goals, and their impact on PG&E's construction plans. (This is accomplished by our issuance today of OII No. 26.)

The staff's recommended rate of return reducton is .05 percent or $5.8 million of gross revenues. The rate of return recommendation was designed by the staff to stimulate PG&E's conservation efforts without depriving it of necessary revenues.

The Energy Commission's Analysis

The Energy Resources Conservation and Development Commission (Energy Commission) participated extensively and filed briefs. It submitted constructive recommendations to improve the effectiveness of PG&E's programs, and concluded that we should question the vigor and imagination of PG&E's conservation efforts. No recommendation on a rate of return adjustment for inadequate conservation measures was submitted by the Energy Commission, stating in its opening brief:

> "The CEC will not attempt to make any recommendations with respect to a specific rate of return, particularly given the absence of any guidance from previous PUC decisions in defining the precise mechanism for adjusting the rate of return according to the three conservation criteria of vigor, imagination, and effectiveness. We believe that in the absence of guidelines or standards for a utility to meet in demonstrating the vigor, effectiveness, and imagination of its conservation programs, it is impossible for either interested parties or the PUC to assess the inadequacy of utility conservation programs. We furthermore believe that the lack of such guidelines inhibits effective regulation of utility conservation efforts. We, therefore, urge the Commission to explicitly define and explain criteria for determining the vigor, effectiveness, and imagination of conservation programs and the method for applying these criteria to rate of return adjustment decisions."

The Energy Commission's evaluation of PG&E's programs, and its proposed recommendations, are as follows:

1. *Insulation Programs.* PG&E is criticized for not studying the extent to which the insulation program could be expanded, and for not developing specific information on the cost-effectiveness of attic insulation.

If PG&E developed better information on cost-effectiveness, customers may be more likely to insulate and the insulation program could be realistically evaluated. The Energy Commission urges that a program be developed to make landlords retrofit insulation.

2. *Appliances and Devices.* The Energy Commission questions PG&E's incentive program to induce sales of pilotless gas ranges because the Energy Commission has adopted regulations mandating such ranges as of July, 1978. Also, the incentive program to encourage retrofitting conventional light fixtures to fluorescent was questioned, and it was suggested that funds could be better used for hiring additional energy auditors.

3. *Commercial-Industrial Audits.* The Energy Commission believes energy audits are "outstanding" as a cost-effective conservation activity. It proposes accelerating the program.

4. *Swimming Pool Time Clock Program.* It is recommended that PG&E's program should be specifically ordered by the Commission because it holds great conservation promise.

The Energy Commission concludes in its opening brief that:

> "It is impossible to determine at this time, however, whether or not PG&E's claimed savings are true and even more importantly, whether or not such savings indicate an effective conservation program. For example, factors other than conservation may slow demand in an area, and conversely, there may be significant conservation savings even with increased demand. Yet PG&E's current conservation measurement techniques, such as its estimate that it is responsible for 75% of insulation sales in its service area because

> a similar percentage of people recall its advertising, are inadequate in making a proper assessment of effectiveness. A far more accurate and sophisticated evaluation and monitoring system, that goes beyond merely estimating savings, is needed. Such a system would include assessment of what actions actually occurred and what was the actual effect on those actions on energy consumption.
>
> "Careful examination is also needed, on an individual customer level, of other factors influencing usage to ensure the effect of such factors are not mistaken for conservation. Finally, there must be thorough integration of achieved and estimated results with PG&E's demand forecast and supply planning. This integration is necessary if conservation is to actually replace currently planned new facilities and supplies, as the PUC has declared it should."

Position of the Environmental Defense Fund (EDF)

The EDF participated extensively, and presented numerous meritorious suggestions and observations. We are impressed by witness Willey's testimony. Today we are issuing OII No. 26 to fully explore PG&E's resource planning, both short- and long-term for as EDF points out:

> "The Commission's recent experience with SDG&E and Sundesert shows the importance of timely review, by it, of at least the major elements of a utility's long-range supply plan. It also highlights the importance of undertaking such review in comprehensive fashion, not merely plant by plant as each one is proposed." (EDF opening brief, p. 13.)

In addition to OII No. 26, we are ordering PG&E to commence immediately studies on, among other things, generating facility repowering. We would not be discharging our duty to the ratepaying public if we failed to

actively oversee the reasonableness of proposed utility resource plans.

EDF believes PG&E has set its conservation goals too low and understates the potential for conservation. It is EDF's recommendation that PG&E's rate of return be reduced resulting in a gross revenue reduction of $79.8 million.

Position of TURN

TURN believes PG&E's conservation efforts have been and are less than mandated by the Commission. It states that the staff has not fully investigated the test year conservation budget to determine the reasonableness of PG&E's estimate. In particular, TURN questions whether PG&E's management should have the discretion of devising and implementing conservation programs because TURN believes it is an inherent conflict of interest for an energy utility to promote conservation.[6] Another TURN position is that local governmental entities should undertake conservation programs, and that increasing PG&E's rates to fund the utility's conservation efforts results in a drain on financial resources that could otherwise be raised for local conservation programs.

City of Palo Alto and Southwest Gas

Palo Alto and Southwest request that PG&E's expense for conservation programs not be passed on to them (and ultimately their customers), and that rates be accordingly reduced. In essence, both Palo Alto and Southwest contend that they have their own on-going conservation programs; that PG&E's conservation activities have little direct impact on their customers; and that an undue bur-

[6] To mitigate this result we adopted SAM (see the earlier discussion on gas revenues) and are issuing an OII into whether and how to establish a similar SAM for electric utilities.

den would be placed on their own customers if those customers must bear a portion of PG&E's conservation expenses in addition to those of their own supplying utility. We cannot grant this request.

First, as extensively discussed in Decision No. 89315, issued today in Application No. 55510 (Phase II), the resale rate is not based on a compilation of incremental costs from which one identifiable expense (such as conservation promotion) can logically be deducted.

Second, Palo Alto and Southwest, as all gas users, benefit from PG&E's conservation efforts. California's gas supply must be conserved and made to continue as long as possible to avoid severe economic hardship on the State. It is in the public interest for *all* who distribute gas, public and municipal utilities alike, to take steps to conserve.

If we adopted the policy suggested by Palo Alto, it could lead to a multitude of resale customers or local jurisdictions claiming that in view of their respective conservation efforts they should not contribute to PG&E's conservation programs. Such a policy would be shortsighted. Entities should not quibble over bearing the obligation to encourage conservation. They collectively benefit from the efforts of each in that there will be gas available for a longer period if conservation is promoted. Palo Alto's request, based on the foregoing, is not reasonable or in the public interest.

Position of UC

The principal fault UC finds with PG&E is in the area of cogeneration. It thinks PG&E's policies discourage developing cogeneration generating potential, based on its attempts to develop a cogeneration project at its Davis Campus. The conclusions were that PG&E's Schedule No. S-1 standby tariff is unnecessary and should be elimi-

nated and that the Commission should establish tariffs requiring PG&E to purchase energy and capacity for a cogenerator at the same rate PG&E would sell energy and capacity to that cogenerator.

Discussion

It is apparent that many parties find fault with PG&E's conservation efforts. Our reservations are also discussed in the rate of return section of this opinion. There are areas where PG&E's management is not aggressively taking the steps it should, and in addition to issuing OII No. 26 today, we will order studies to begin immediately into the following:

1. Repowering existing generating facilities, both steam plants and hydroelectric units.

2. Expanding existing facilities and facility maintenance and modification as an alternative to new facilities.

3. Sources of auxiliary and cogenerated power which can be used during high demand periods.

Despite some apparent shortcomings in PG&E's conservation effort we are of the opinion that we should not reduce its authorized rate of return. We discussed earlier, however, that if PG&E had been more imaginative in exploring resource options we would be inclined to authorize a higher return on equity.

PG&E generally contends that the staff's criticisms are the result of not being familiar with PG&E's actual conservation effort. The defense of PG&E in opposing the staff's recommended rate of return adjustment is stated in its opening brief (p. 153):

> "PGandE does not claim that all of this reduction in gas and electricity consumption is due to its conservation efforts alone; there are numerous other economic and social factors impacting gas and electricity consumption patterns. However, PGandE does have an active and extensive conservation program and the ultimate goal that this Commission is seeking to attain, a reduction in consumption, is occurring. To assert that PGandE, and thus its top management, are not pursuing conservation diligently when sales are defying historic patterns is unreasonable.
>
> "Fourth, what the Staff describes as a lack of top management diligence in promoting conservation is, in fact, the reasonable and prudent response of top management to hesitant, ill-defined, and inconsistent Commission conservation policies."

PG&E states that EDF's recommendations, as they pertain to adjusting allowed expenses and rate base as a means of imputing a long-range resource plan, is "destructive to the concept of test year ratemaking." Although, as indicated previously, we are impressed by EDF's presentation, we are not convinced that it is reasonable to adopt a specific revenue requirement adjustment as proposed by EDF at this time. In order to not delay PG&E's next general rate proceeding and allow a forum for the staff, EDF, and PG&E to fully explore resource planning, it is appropriate to issue OII No. 26. We expect timely responses by PG&E to the data requests of the staff and interested parties in that OII, for the issues to be addressed are critical and we must explore them as rapidly as possible. The policy conclusions we reach as a result of OII No. 26, in which EDF may and should participate, will be implemented. And in subsequent rate proceedings we can insure prudent resource policies are followed; if they are not, we can impute the operating efficiency as suggested by EDF in adopting a reasonable test year results of operations.

We believe some of the parties forget that conservation, undertaken on a massive scale, is a relatively new

science. Much progress has been made, and many more innovations and ideas will emerge as utilities, consumers and regulators head, as they must, toward a conservation-oriented energy policy. It is well settled in our minds that continued growth of new generating capacity is too financially and environmentally expensive for Californians. The many recommendations of the parties, and just the issues they raised, is, in our opinion, an excellent education for PG&E. The utility's management should carefully review the material and testimony on conservation submitted in these proceedings, for it is apparent PG&E does not have a monopoly on answers or talent in the conservation field.

We will continue our review of PG&E's conservation activity in the next general rate proceeding. If we conclude that management is recalcitrant or lazy in implementing conservation programs and prudent resource plans, we will *not* be hesitant to adjust rate of return more drastically than proposed by the staff in these proceedings.

We do not, however, feel that this should be the only means by which we should encourage conservation efforts. At the onset of the energy crisis, the Commission was not staffed to effectively direct specific utility conservation programs, thus primary reliance was placed upon the resources of utility personnel and management. Now that we have reorganized and manned our staff to effectively address conservation issues, we will undertake a much more active role in establishing and directing, as well as monitoring, specific utility conservation programs. Such Commission leadership exercised in conjunction with appropriate rate of return adjustments should prove more effective in achieving energy conservation than the rate of return sanction alone.

We would like to reiterate that our insistence on an overall conservation ethic and approach on the part of

PAGES 67 & 68 WERE
MISSING FROM EACH
COPY OF THE APPENDIX
FILED WITH THE COURT

PAGES 67 & 68 WERE
MISSING FROM EACH
COPY OF THE APPENDIX
FILED WITH THE COURT

67b & 68b missing

Commission Staff

The staff recommended rate spread at 100 percent of the requested increase averages 8.1 percent (Exhibit 69). Average increases by priority are: P-1 residential—7.8 percent; P-1 and 2, commercial and industrial—8.3 percent; P-3, 4, and 5—8.2 percent; and resale—8.1 percent.

Staff recommendations for residential customers include a $1.30 customer charge and five tiers at the following per therm rates: TIR—.1523, TIIR—.2009, TIIIR—.2132, TIVR—.2255, and TVR—.2377.

The staff proposal includes a three-tier nonresidential P-1 and P-2 rate structure at the following per therm rate: TIC—.2255, TIIC—.2377, and TIIIC—.2431. The purpose of the tiered design is to encourage conservation. The recommended P-3, 4, and 5 per therm rate is .2477; the resale lifeline and nonlifeline rates are .1523 and .2051, respectively. Significant changes for resale customers include modification for lifeline allowances based on current usage and elimination of the demand charge.

In addition, the staff was asked by the hearing officer to give its recommendation on special rate consideration for residential gas air conditioners.

According to the staff (Exhibit 91), "The existing rate structure is reasonable for gas air conditioning use and no special allowances are necessary."

California Manufacturers Association (CMA)

CMA believes that the manner in which the very large rate increases of the last several years have been spread has resulted in a system rate design that is out of balance. While this Commission's actions during this period have responded to changing conditions and concerns, chief among them the lifeline legislation and a rapidly diminishing gas supply, those actions, according to CMA, seem to have been taken hurriedly and without full consideration

of their effect on customers and the utility. According to CMA, the rates paid by industrial customers have skyrocketed, only in part due to the increased costs experienced by PG&E. As a result of the rate design policy adopted by the Commission, CMA believes numerous problems have been created for customers and the utility.

CMA believes that the present rate design deceives large numbers of residential customers into believing that gas is an inexpensive commodity and that the installation of facilities necessary to provide service costs virtually nothing, while at the same time working to discourage uses of gas by other customers which are both efficient and useful. It believes that the existing rate design is so out of balance that it is not practical to correct the problem fully in this proceeding. But, as it also believes that the Commission should make a significant move in that direction in this proceeding, it recommended the following rate design:

Transitional CMA Rate Proposal

Residential	Present	Future
Customer Charge	$1.20/Mo.	$2.50/Mo.
Lifeline Commodity Charge	$0.1417/Th.	$0.175/Th.
Tier 2 Commodity Charge	$0.200/Th.	$0.2353/Th.
Tier 3 Commodity Charge	$0.219/Th.	$0.3006/Th.
Priorities 1 and 2		
Customer Charge	$1.20/Mo.	$6.90/Mo.
Commodity Charge	$0.219/Th.	$0.213/Th.
Priorities 3 and 4		
Commodity Charge	$0.229/Th.	$0.229/Th.
Priority 5		
Commodity Charge	$0.229/Th.	$0.229/Th.
Resale		
Commodity Charge	$0.1735/Th.	$0.1735/Th.

Kerr-McGee Chemical Corporation (Kerr-McGee)

Kerr-McGee proposed two separate and alternative methods of spreading the revenue increases sought by PG&E. The first rate proposal was called the "Equalized Markup" or "EMU" proposal and the second was called a "Conservation Incentive Rate Design" or "CI" design. The EMU rate design starts with costs incurred by PG&E to serve tthe various customer classes and involves other ratemaking factors in spreading in an equitable and conservation promoting fashion, the burden which has been imposed upon nonlifeline customers in order to subsidize below-cost service to lifeline users. The CI proposal is principally intended to promote the Commission's objective of energy conservation rates and improve stability of earnings.

Kerr-McGee selected a specific rate design that in its opinion should be adopted by the Commission. The recommended CI rate design is characterized by the following parameters: (1) a $2.40 per month residential customer charge; (2) the lifeline commodity rate of 15.68 cents per therm proposed by PG&E; (3) a uniform commodity charge equal to the application rate for interruptible gas usage of 21.48 cents per therm; (4) a uniform nonresidential general service customer charge of $12.97 per month; and (5) a CI charge of $.44378 per factor month.

The rate design proposals of CMA and Kerr-McGee place emphasis on increasing fixed customer charges. We have repeatedly found that it is reasonable to price gas by units of use as a means of encouraging conservation. If we adopted high fixed customer charges, the units of gas consumed could not be priced to result in the greatest savings to the customer for conserving units of gas use. Accordingly, we find that CMA's and Kerr-McGee's proposals are not reasonable and in the public interest.

Southwest Gas Corporation (Southwest)

Southwest recommends and urges adoption by the Commission of a commodity-type rate or two-part commodity-type rate or single commodity-type rate, with the elimination of the demand component of the two-part PG&E rate that is listed in Schedule No. G-63.

City of Palo Alto (Palo Alto)

It is Palo Alto's position that its Municipal Utility be exempt from gas rate increases due to PG&E's conservation program expenses for the following reasons:

1. PG&E's conservation programs do not directly benefit the Palo Alto Gas Utility as a resale customer.

2. PG&E's conservation programs do not directly benefit the customers of the Palo Alto Gas Utility.

3. Palo Alto should be given credit for its own conservation programs.

4. The imposition of a rate increase to cover PG&E's conservation programs would impose an inequitable burden upon Palo Alto's customers.

Regarding the proposal by the staff and PG&E to institute uniform commodity rates for all resale customers, it is Palo Alto's position that uniform rates have been proposed for simplicity and administrative convenience. However, an important matter must be brought to the attention of this Commission. Applying uniform rates to resale customers will deny Palo Alto a gas rate decrease recently granted, and reinstate a previous offset increase to Palo Alto which this Commission has ordered to be modified (Decision No. 88310). Since PG&E and staff published their proposed uniform resale commodity rates, an appropriate rate reduction has recently been granted Palo Alto. On January 10, 1978, Decision No. 88310 was rendered reducing Palo Alto's commodity rate $.0032 per therm for nonlifeline

usage. This decision corrected an unintended large increase to Palo Alto's G-60 rate schedule from previous offset Decision No. 87585 and did not affect the other resale schedules.

If uniform rates are implemented to all resale customers, Palo Alto will certainly lose this recent rate decrease. In so doing, the unintended large increase that was applied to the G-60 rate schedule as a result of Decision No. 87585 will be reinstated, and Palo Alto will be burdened with an increase in gas purchases of approximately $83,000 per year. It is Palo Alto's position that this rate reduction of $.0032 per therm for nonlifeline usage be reflected in the arrived at G-60 commodity rate. To ignore this rate reduction would be improper and mathematically incorrect.

Regarding uniform commodity rates for resale customers, it is Palo Alto's position that uniform rates are inequitable for a broader reason; all resale customers are not alike. Indicative of this diversity is the four different resale lifeline percentages. Staff and PG&E did not recommend a uniform lifeline percentage for all resale customers.

We have already addressed Palo Alto's request for a rate adjustment as a result of its conservation efforts in the preceding portion of this opinion on PG&E's conservation activity. As for the remaining resale rate issue, we today issued Decision No. 89315, in Application No. 55509 (Phase II), which directs that Palo Alto's resale rate be established in this proceeding to provide a 20 percent differential between gross revenues and purchased gas expense which is equivalent to $0.0458/therm of Palo Alto's purchases (using PG&E's general service rates as a basis of establishing this differential). That issue was extensively addressed in that proceeding, and essentially the same arguments were presented then as in this proceeding. We find that PG&E's resale rate to Palo Alto should be established to allow Palo Alto the $0.0458/therm differen-

tial over purchased gas cost pursuant to Decision No. 89315, in Application No. 55509.

Adopted Gas Rate Design

The combined revenue increases from Application No. 57285 and Phase I of Application No. 57978 will produce an overall increase in excess of 12 percent. This is a substantial increase that requires careful placement in order to satisfy our ongoing concerns for a healthy industrial and living environment while continuing to encourage conservation.

In our previous Decision No. 87585, the rates to the lowest priority industrial customers were set so as to provide a planning signal for the equating of natural gas with alternative fuels or with the incremental cost of new (and incrementally the most expensive) natural gas supplies. PG&E has testified that some of its large industrial P-3 and P-4 customers have discontinued gas service and have converted to alternative fuels, particularly when oil prices fluctuate downward.

The erosion of sales to these two classes of customers prompted PG&E to develop and propose Schedule No. G-52 in Application No. 57978 (the record of which is incorporated into these proceedings). The two salient features of the Schedule No. G-52 rates were its applicability based on the type of alternative fuel that the customer was capable of using[8] and the proposed reduction from the present 22.90 cents per therm to a flat 20.00 cents per therm. Although PG&E did present evidence to support

[8] "*APPLICABILITY*

"Applicable to natural gas service to uses classified in Rule No. 21 as P3 and P4, for which the alternate fuel is exclusively oil with a viscosity higher than 150 Saybolt Seconds Universal (SSU) at 100°F (commonly referred to as Grade No. 5 and Grade No. 6 fuel oil)."

its proposed Schedule No. G-52 rate, the objections raised, concerning potential price fluctuations of the alternative fuel market, the distinctions between P-3 and P-4 customer characteristics, the staleness of the information used and the general naivete of the study suggest that more work needs to be done before substantial weight can be given to the proposed rate.

On the other hand, the undisputed departure of certain customers from PG&E's system is indicative that the gas price adopted in Decision No. 87585 represents a plateau from which to survey the alternative fuel market. We will therefore authorize a Schedule No. G-52 rate as proposed by PG&E, but we find that a rate of 22.90 cents per therm is reasonable. This will provide a point of stability in our alternative fuel pricing policy. As more information is developed by the staff, PG&E, and other interested parties, further opportunities for differentiation along the lines of alternative fuel use may present themselves. For the future, PG&E's semiannual Gas Cost Adjustment Clause (GCAC) and SAM filings should be used to develop and maintain rates that are current and competitive with respect to alternative fuels and new gas supplies.

The remainder of the customers in P-3 and P-4 classes, while capable of using alternative fuels, has selected alternative fuels that are generally accorded a higher price in the market place. Some increase to these customers is therefore justified and reasonable if their alternate fuel cost is taken into account. For this reason, the Schedule No. G-50 rate will be increased by 10 percent from 22.90 cents per therm to 25.20 cents per therm.

The next substantial issue relates to the question of lifeline rates. PG&E has indicated that systemwide average gas rates have increased more than the statutory 25 percent of rates in effect on January 1, 1976. We believe it is reasonable and appropriate to allocate a portion of the revenue requirement increase to lifeline usage. Consid-

ering that the average increase under these applications is in excess of 12 percent and that lifeline customers have not, until now, received any increases, a rate increase of 16.6 percent (from 14.17 cents per therm to 16.52 cents per therm) will apportion a reasonable share of this increase to the first usage block, or lifeline quantity.

The rates to nonresidential P-1 and P-2 customers will also be increased by 16.6 percent. This will reasonably maintain the rate relationship between residential lifeline usage and other high priority customers who do not have alternative fuel capability.

Residential rates for quantities in excess of lifeline usage will be increased substantially and in a manner to promote conservation. The rate increases will provide a steeper gradient than the present inverted rates, and thereby further encourage residential customers to conserve use of natural gas and to adopt alternative and renewable energy sources such as solar. This course of action was recommended by Alten Corporation to improve the economics of solar conversions and prevent waste of natural gas; that effect, in the context of a sound, long-range energy policy for California, is most desirable.

In order to focus the economic effect of our rate changes on summer use, the 5-tier residential rate should be modified. The winter Tier IV will be lowered to Tier II and the excess winter usage will be charged at the Tier IV rate instead of the Tier V rate. The blocking and applicable volumes are shown on the following Table G-1:

Table G-1

PACIFIC GAS AND ELECTRIC COMPANY
REVISED RESIDENTIAL TIERS

		Blocking (Therms)			
Current		Winter			
Tier	Summer	W	X	Y	Z
I	26	81	106	141	166
II	26	—	—	—	—
III	26	—	—	—	—
IV	26	81	106	141	166
V	+104	+162	+212	+282	+332
Revised					
I	26	81	106	141	166
II	26	81	106	141	166
III	26	—	—	—	—
IV	26	+162	+212	+282	+332
V	+104	—	—	—	—

Volumes (MMTH)

	Current			Revised		
Tier	Summer	Winter	Total	Summer	Winter	Total
I	—	—	1,619.8	—	—	1,619.8
II	234.8	0	234.8	234.8	320.8	555.6
III	96.3	0	96.3	96.3	0	96.3
IV	37.3	320.8	358.1	37.3	136.5	173.8
V	118.7	136.5	255.2	70.5	0	118.7

The foregoing rate design changes and associated sales volumes and revenues are shown in the following Table G-2. The disposition between the increases attributable to Application No. 57285 and to Phase I of Application No. 57978 are shown in Table G-3.

A bill comparison is shown in Table G-4 for the changes in residential rates. This illustrates the magnitude of the increases that the individual customer will experience at various consumption levels.

Table G-2

Gas Department Rates
Year 1978 Estimated

Category	Volume MM Therms		Present Rates (7-12-77)		Authorized			
					Rate	Revenue	Increase	
	Present	Adopted	$/Therm	MM$	$/Therm	MM$	MM$	%[2] Rate
Customer Months	31.6		1.20	37.9	1.20	37.9	—	—
Priority 1 (Residential)[1]								
Tier I (Lifeline)	1619.8	1619.8	.1417	229.5	.1652	267.6	38.1	16.6
Tier II	234.8	555.6	.1804	42.4	.2500	138.9	96.5	38.6
Tier III	96.3	96.3	.1896	18.3	.2750	26.5	8.2	45.0
Tier IV	358.1	173.8	.2160	77.3	.3000	52.1	(25.2)	38.9
Tier V	255.2	70.5	.2190	55.9	.3760	26.5	(29.4)	71.7
G-1 N (Non-Lifeline)	—	48.2	.2190	—	.2750	13.3	13.3	25.6
Total Residential	2564.2	2564.2	.1651	423.4	.2047	524.9	101.5	24.0
Non-Residential								
Priority 1 & 2 (G-2)	1852.1		.2190	405.6	.2554	473.0	67.4	16.6
Priority 3 & 4 (G-50)	882.3		.2290	202.0	.2520	222.3	20.3	10.0
Priority 3 & 4 (G-52) (new schedule)	360.0		.2290	82.4	.2290	82.4		
Priority 5 (G-57)	87.0		.2290	19.9	.2290	19.9		
Priority 5 (G-55)	1665.2		.2290	381.3	.2290	381.3		
Total Non-Residential	4846.6		.2251	1091.2	.2432	1178.9	87.7	8.0
Resale								
Lifeline†	41.0			5.4		6.2•	0.8	16.6
Non-Lifeline	61.8			12.0		12.2	0.2	1.4
Total Resale	102.8		.1693	17.4	.1795	18.4	1.0	6.1
Total Sales	7513.6		.2089	1569.9	.2343	1760.1	190.2	12.1
Other Revenue				1.6		1.6		
Total Revenue				1571.5		1761.7		

[1] Residential Sales Adjusted by 9.4 MM Therms for G-10 and G-S Discounts.

[2] Percent Increase Based on Rate per Therm.

• Rounded Down.

† Reflects reduced revenue at present rates due to revised lifeline allowance.

(Red Figure)

Table G-3

Gas Department Revenues
Year 1978 Estimated

Category	Present Rates	Allocated Increase			At Adopted Rates
		General A-57285	Offset A-57978	Total	
	MM$	MM$	MM$	MM$	MM$
Customer Months	37.9	0	0	0	37.9
Residential					
Lifeline	229.5	20.0	18.1	38.1	267.6
Non-Lifeline	193.9	33.3	30.1	63.4	257.3
Total Residential	423.4	53.3	48.2	101.5	524.9
Non-Residential					
Priority 1 & 2	405.6	35.4	32.0	67.4	473.0
Priority 3 & 4 (G-50)	202.0	10.7	9.6	20.3	222.3
Priority 3 & 4 (G-52)	82.4	0	0	0	82.4
Priority 5 (G-57)	19.9	0	0	0	19.9
Priority 5 (G-55)	381.3	0	0	0	381.3
Total Non-Residential	1091.2	46.1	41.6	87.7	1178.9
Resale					
Lifeline†	5.4	0.4	0.4	0.8	6.2
Non-Lifeline	12.0	0.1	0.1	0.2	12.2
Total Resale	17.4	0.5	0.5	1.0	18.4
Total Sales	1569.9	99.9	90.3	190.2	1760.1
Other Revenue	1.6				1.6
Total Revenue	1571.5				1761.7
Percentage Allocation		52.5%	47.5%	100.0%	

† Reflects reduced revenue at present rates due to revised lifeline allowance.

Table G-4

GAS DEPARTMENT

Residential Bill Comparisons

Therms Billed	Present Rates	Adopted Rates	Increase Amount	Increase Percent
		Summer (All Areas)		
0	$ 1.20	$ 1.20	$ —	— %
26 [1]	4.88	5.50	0.62	12.7
52	9.57	12.00	2.43	25.4
104	20.12	26.95	6.83	33.9
200	41.14	63.04	21.90	53.2
400	84.94	138.24	53.30	62.8
700	150.64	251.04	100.40	66.6
		Winter—X Climatic Band [2]		
0	$ 1.20	$ 1.20	$ —	— %
52	8.57	9.79	1.22	14.2
106 [1]	16.22	18.71	2.49	15.4
212	39.12	45.21	6.09	15.6
400	80.29	101.61	21.32	26.6
700	145.99	191.61	45.62	31.2

[1] Lifeline allowance.

[2] Represents majority of customers in the PG&E service area. Bills in other climatic bands would vary depending on lifeline allowance.

We found in our concurrent decision in Application No. 55510 that Palo Alto is to be served by PG&E under a Schedule No. G-60 resale rate that will allow Palo Alto a 20 percent differential between gross revenues and purchased gas expense which is equivalent to $0.0458/therm of their purchases. Having established this underlying principle for determining the resale rate to Palo Alto, we believe it is equitable to apply similar percentage increases for PG&E's other resale customers also serving primarily high priority customers.

To establish the differential for Palo Alto, sales and revenues were developed based upon Palo Alto's lifeline proportion of 33.7 percent and lost and unaccounted for of 3.11 percent, PG&E's estimated sales volumes, and the adopted PG&E profile of sales to P-1 and P-2 customers in the manner shown below.

PALO ALTO RATE DERIVATION

	Proportion	Sales Volume Mdth	Adopted PG&E Rates $/th.	Equivalent Revenue M$
I. *Sales*				
Residential				
Lifeline	33.7%	1,428	$ .1652	$ 2,359
Other Than Residential				
Lifeline				
Tier II	13.2	559	.2500	1,398
Tier III	2.3	97	.2750	267
Tier IV	4.1	174	.3000	522
Tier V	1.7	72	.3760	271
Schedule G-1 N	1.1	47	.2750	129
Priority 1 & 2				
Nonresidential	43.9	1,861	.2554	4,753
Subtotal—Other	66.3	2,810		7,340
Total	100.0	4,238		9,699
Customer Charge		254.2	1.20	305
Total Rev.				10,004
80% of Rev.				8,003
II. *Purchases*				
LL = 1,428 Mdth × 1.0311 =		1,473	.1540	2,268
NLL = 2,810 Mdth × 1.0311 =		2,897	.1979	5,733
Total Purchases		4,370		8,001

The principal portion of the increase was applied to the lifeline tier in the same proportion as was applied to PG&E, namely 16.6 percent. The small remainder represented an increase of 1.4 percent to nonlifeline P-1 and P-2 sales. This application of the increase provides similar treatment to lifeline quantities for PG&E's customers and lifeline quantities for customers served by resale entities, while still answering Palo Alto's concerns about its lack of industrial customers to absorb differential increases. Similar percentage increases to the lifeline and nonlifeline components of PG&E's other resale rates provide a reasonable overall increase of 6.1 percent to the resale customer class.

The treatment of Palo Alto as the bellwether for the resale class appears reasonable at this time. To a certain extent, Palo Alto's justification for a less than average increase also applies to Coalinga, C-P National, and Southwest. Their increases are 8.1 percent, 5.9 percent, and 6.6 percent, respectively, all below the system average of 12.1 percent. In future proceedings, this relationship may be continued, but only after scrutiny.

Electric Rate Design

Electric Rate Design Proposals

PG&E

PG&E's original electric rate proposal has been affected by the adoption of the electric rate stabilization plan in Decision No. 88262 issued December 20, 1977. It may be further affected by decisions in Application No. 57666, the time-of-use application for customers between 1,000-4,000 kw of demand, and in Case No. 10273, dealing with master-meter rates for mobile home parks. In consonance with Decision No. 88262, PG&E's electric rate proposal is to establish base rates as set forth in Chapter 3 of Exhibit 2, as amended by Exhibit 9, and to reduce its Energy Cost Adjustment (ECA) by an equivalent amount so that there will be no net increase in PG&E's gross revenues.

To achieve the offsetting Energy Cost Adjustment Clause (ECAC) reduction, PG&E proposes to revise two of the present three ECAC charges. The present ECA amounts are $0.01003 for lifeline usage, $0.02444 for the first rate block of nonlifeline residential usage, and $0.02921 for all other usage subject to the ECA. PG&E proposes that the lifeline ECA of $0.01003 remain unchanged. The ECA of $0.02921 for nonresidential usage would be reduced by $0.00219 per kilowatt-hour to $0.02702. Also, the ECAs of $0.02444 and $0.02921 now applicable to residential service would be changed to a weighted average ECA of $0.02651 for all nonlifeline residential usage.

PG&E in this proceeding has included proposed Schedule No. A-13, for time-of-use customers between 1,000-4,000 kw of demand. This assumes a transfer of customers from existing schedules, primarily Schedule No. A-13. Schedule No. A-22 is the subject of Application No. 57666, which is expected to authorize its implementation at current revenue levels prior to the decision in this application. Should that occur, the decision in this application should recognize the existing Schedule No. A-22 and increase the rates appropriately. If Schedule No. A-22 has not yet been authorized in Application No. 57666, then customers should continue on existing schedules (primarily Schedule No. A-13) at the proposed rate levels. The pattern of offsetting ECAC reductions described about would still be valid since the same amount of revenues would be generated under either Schedule No. A-22 or existing schedules.

A revenue reduction may result from Case No. 10273. The exact amount cannot be established until the decision is issued in that case. Based on the rate design in the preliminary report of the ALJ and on the special discounts recommended by the staff in that case, the electric revenue reduction in base rates would be $1,882,000 to reflect the

effect of the change in the Public Utilities Code effected by Section 739.5. PG&E proposes that this reduction in revenues should be offset by a uniform increase of $0.00004 per kilowatt-hour in the base rates proposed in Chapter 3 of Exhibit 2. This change would not require any further adjustment in the ECAC rate.

PG&E also proposes, to include in LS-1, rates for lamps installed on company-owned poles (Class D), metal poles (Class E), and wood poles (Class F) installed solely for the luminaire, open LS-3 to new service and cancel LS-4. The company also proposes to charge for temporary discontinuance of service and to require a five-year contract for initial service.

Commission Staff

The staff witnesses' recommendations are summarized as follows:

1. The increase in base rates resulting from Decision No. 88262 should be considered as an interim increase and be replaced by the rate increase recommendations contained in Exhibit 74 which reflect changes in monthly charges, demand and commodity rates, and consolidation and elimination of certain schedules.

2. The Commission should consider marginal costs in reaching its determination of revenue increases by class within the ranges shown in Exhibit 74, and further and more directly, consider marginal costs in the individual rates selected as recommended in Chapters 4, 5, and 6 of Exhibit 74.

3. Lifeline rates partake of a reasonable share of revenue increases resulting from this application.

4. The Commission gives recognition to the reduction in revenue requirements for this group (which result from a 5 percent demand reduction) through a reduction in the

revenue increase to be assigned to this group. The reduction in revenue requirements for a 5 percent demand reduction is $3,818,000.

5. Domestic Schedules Nos. D-1 through D-5 should be consolidated into one Schedule No. D-1. Density zones should be eliminated and the present base rate structure should be inverted. The present three ECA factors applicable to domestic schedules should be consolidated into two factors (lifeline and nonlifeline). The air conditioning allowance and its reduced rates should apply only to the geographic areas proposed by the staff. The DM or master-metered schedule should be closed to new applicants and submetering for existing customers should be encouraged.

6. Electric bills should be fully itemized showing the appropriate kwhr lifeline allowance, lifeline and nonlifeline consumption, applicable rates, and the total bill. An explanation of each item should be added whenever possible.

7. General Service Schedules Nos. A-1 through A-5 should be consolidated into one Schedule No. A-1. Schedules Nos. A-16, H-1, P-1, P-3, and P-60 should be canceled and these customers should be transferred to the appropriate Schedule No. A-1 or Schedule No. A-12. The direct current Schedules Nos. A-15 and P-5 should be combined into one A-15. Schedule No. OL-1 should be closed to the installation of any mercury vapor lamps for new customers. Schedule No. A-12 and the demand portion of Schedules Nos. A-41, P-3, and P-60 should be consolidated into one Schedule No. A-12, with the elimination of the 5,000-kwh block. The agricultural schedule should be revised to reduce the number of rates from seven to one.

8. Streets and Highway Lighting Schedules Nos. LS-60 and LS-61 should be canceled and the customers transferred to Schedule No. LS-1A. Schedules Nos. LS-3 and LS-4 should be combined into one Schedule No. LS-3. The format of Schedules Nos. LS-1 and LS-2 should be revised

to include the nominal lamp rating in watts, lumens, line watts, and charges for different kinds of poles.

9. Incandescent lamps including 2,500 lumens and under should be allowed while lamps over 2,500 lumens should not be allowed for new customers under Schedule No. LS-2. PG&E should develop a program whereby incandescent lamps under Schedule No. LS-1 are replaced with more efficient lighting over a five-year period.

The following tables shows the staff's range of revenue increase by class for 1978 test year:

Class of Service	Staff Range of Revenue Increase[1] Low[2]	Staff Range of Revenue Increase[1] High[2]	Rate of Return by Class—Percent Present Rates[3]	With Staff Range of Increase Low[4]	With Staff Range of Increase High[4]
	(Dollars in Thousands)				
Residential	$ 52,100	$ 60,000	3.67%	4.82%	5.01%
Small Light & Pwr.	13,900	24,800	14.55	15.85	16.93
Medium Light & Pwr.	35,500	37,700	13.26	15.57	15.70
Large Light & Pwr.	24,459	40,402	13.36	15.75	17.10
Agricultural	10,600	11,600	10.24	12.61	12.81
Street Lighting	1,493	3,400	8.96	9.94	11.03
Subtotal	138,052	177,902	8.48	10.33[5]	10.33[5]
Public Authority	700	918	•	•	•
Railway	331	805	•	•	•
Interdepartmental	418	447	•	•	•
Other Oper. Rev.	329	329	•	•	•
Total Oper. Rev.	139,830	180,401	8.48	10.33[5]	10.33[5]

• Rates of return not computed. To maintain a total rate of return of 10.33 percent total revenue increase for these four classes must equal total requested by utility.

[1] Excludes public authority, railway, interdepartmental, and other class revenue increases.

[2] No attempt is made to make low and high class revenue add to the amount requested by the utility.

[3] Monthly peak responsibility method adjusted for ECAC energy cost allocation.

[4] Low and high rates of return for each class are computed assuming all other class revenues adjusted to yield $158,779.

[5] Utility requested rate of return.

California Retailers Association (CRA)

CRA proposes the establishment of a cost standard for lifeline rates as, according to CRA, it was obviously the intent of the legislature that lifeline rates should be lower than the average kilowatt-hour rate. It believes it is appropriate that lifeline rates should recover only out-of-pocket costs, but no profit to the utility. Thus, the revenue requirement standard for lifeline should be a zero rate of return.

CRA maintains that given that lifeline rates represent a subsidy even to users of greater quantities of electricity than the lifeline allowance, there is no longer any justification for perpetuating the traditionally lower rate of return for conventional residential service that is, the nonlifeline blocks of the residential rate schedules. Thus, it proposes that the rate of return to the nonlifeline residential service be set equal to the average rate of return for all nonlifeline services. These proposals yield a revenue increase from residential service which must then be distributed in the form of offsetting reductions to the nonresidential services. Although there are a variety of ways of distributing this revenue reduction, it proposes that it be based on the kwh energy sales of the respective classes and subclasses.

CRA does not believe that basic lifeline should be expanded to include air conditioning usage.

CRA's comments as regards the time-of-use rates which are now before this Commission are as follows:

> The Commission has designated PG&E's latest time-of-use rate, Schedule No. A-22, for separate consideration in Application No. 57666. However, as CRA's testimony in that proceeding indicates, the issues spill over into the revenue requirements of other services. Specifically, CRA believes that any revenue loss from the shift of consumption from high-rated peak periods to lower rated partial and off-peak periods should be

recovered from the entire spectrum of ratepayers rather than from those customers who happen to be on Schedule No. A-22. Furthermore, CRA observes that the energy charge in Schedule No. A-22, applicable to customers between 1,000 and 4,000 kw, is unreasonably higher than that found in Schedule No. A-17, applicable to customers over 4,000 kw. Correction of this infirmity would require revision of both schedules. For these reasons, the Commission may have to consider PG&E's time-of-day rates in reaching a decision in this proceeding.

The following table compares CRA's class revenue requirement and rate of return with PG&E's proposal:

Class Revenue, Rate of Return
(000 omitted)

	CRA	PG&E	
Residential	$115,921	$102,124	5.8 %
Agriculture	21,691	29,209	11.75
Street Lighting	8,196	8,398	10.04
Light & Power			
Small	73,327	75,182	15.52
Medium	112,510	117,310	14.75
Large	84,941	90,359	15.73
Net for Classes	422,584	422,582	

City and County of San Francisco (city)

According to city, because of rate stabilization there should be no increase to any customer. In addition, city believes no party has justified, on a ratemaking cost-of-service basis, the elimination of zones.

California Manufacturers Association (CMA)

CMA contends that domestic service under 440 kilowatt-hours per month is rendered at a loss of $31 million to PG&E with a negative rate of return.

Further, CMA contends that residential customers are not being given the proper incentives to conserve by the existing rates or those proposed by PG&E or the Commission staff in their proposed electric rate designs; and while some lifeline "subsidy" may be appropriate, an appropriate lifeline rate should provide at least a zero rate of return rather than a negative rate of return for the lifeline class.

CMA believes that authorized rate increases to industrial customers are actually higher in relation to the average increase in electric costs in California than has been the case in the nation as a whole, thus causing a deterioration in the competitive position of California industry with respect to competition from out of California. Also, CMA asserts that the higher marginal costs being considered as alternative rates for industrial schedules may actually impede energy conservation by industry.

CMA's rate design proposal—simply stated—is: Do not raise any industrial rate but place all of the increase on the residential class.

City of Oakland (Oakland)

According to Oakland, the Commission should adopt its street lighting recommendations as follows:

> First, the proposed rates would bring some order to rate schedules which have grown incoherent. The present street lighting rate structure is the result of many years of PG&E advice letter filings. To my knowledge, the structure has never been examined overall for consistency and fairness. The present schedules allow PG&E to overcharge street lighting energy sales and use the revenue to subsidize company maintenance and owning operations. The result has been the vast enlargement of company-owned street lighting plant. Cities and other agencies which use street lighting have been led to depend upon PG&E for street

lighting facilities rather than consider contractor service or agency ownership and maintenance. Competition has been controlled to the company's benefit and to the users' detriment. The Oakland proposed rates would charge all street lighting customers properly and fairly for energy use. In addition, ownership and maintenance costs would be charged only to customers using the service.

Second, the proposed rates would encourage the use of energy efficient lighting. The energy used for street lighting in the PG&E system is 493 million kwh per year. (PG&E 1978 test year estimate.) The same amount of light could be provided with energy efficient lights which would consume only 222 million kwh per year (55 percent reduction).

Oakland further maintains that energy rates for traffic signals have been unusually high compared to rates for other users. In the PG&E rate proposal, the base energy rate for traffic signals is 3.19¢/kwh. With 1978 test year ECAC added, the rate would be 5.63¢/kwh. Oakland contends that the load characteristic for traffic signal service is much better than that for most other service classes, and that PG&E's proposed rate is not supported.

The Oakland proposed base rate is 1.966¢/kwh. With 1978 test year ECAC added, the traffic signal energy rate will be 4.41¢/kwh. Traffic signal energy is metered; therefore, a $1.50/mo. service charge is required. The Oakland proposed allocation of cost to traffic signal service provides revenue amounting to 4.59¢/kwh which is sufficient to recover all fuel, operation, and maintenance expenses for the service, and also allows the return on investment asked by PG&E.

If the Oakland proposed rate is accepted, traffic signal customers will find a reduction in their energy bills.

Airco, Inc. (Airco) and General Motors Corporation (GM)

The position of GM and Airco is that if the Commission grants PG&E the full amount of the increase requested, it would recommend that $115 million of that increase be assigned to the residential class:

$11 million to the small light and power class;
$16 million to the medium light and power class;
$11 million to large light and power;
$4 million to the agricultural class; and
$3 million to the street lighting class.

The balance should be spread among public authority, railway, interdepartmental, and other revenue categories.

If the Commission finds a smaller increase than the amount requested, then they recommend all of those increases should be scaled downward proportionately.

Adopted Electric Rates

In an effort to normalize the electric rate aftermath of the recent two-year drought (causing wide fluctuations in energy costs of PG&E and the ECAC balancing account), we have been attempting to stabilize revenues and rates. We synchronized base rate increases with ECAC rate reductions in Decision No. 88262. And we conclude that it is reasonable to continue our policy of rate stabilization in this proceeding. By Decision No. 89318 in Application No. 58033 (PG&E ECAC) we are reducing ECAC rates by $200 million (0.446 c/kwh). In reflecting that reduction along with the base rates increased by this order, it is our general goal that no overall rate increase (combined base rates and ECAC rates) will result for the various customer classes.

Another objective, as we authorize rates for PG&E, is to eliminate declining block rates. Declining block rates are inconsistent with the goal of encouraging conservation

and slowing the need for costly (financially and environmentally) new generating units. The problem with declining block rates is that the last energy units used (and which could possibly be saved) are less expensive, and the customer does not receive as meaningful an economic signal when he does conserve.

A third objective is to more fully utilize than has been done in previous decisions the concept of marginal cost, and the marginal costs developed in this proceeding. Marginal costs are the one set of costs which, when translated into prices, serve to promote the most efficient use of scarce resources and most usefully indicate to consumers the costs they are imposing on the system. Our movement in the direction of marginal cost pricing represents a major effort in pursuit of the goal of conservation, and in promoting the most efficient use and allocation of resources. The utility and the staff should increase their efforts in developing marginal costs and rates based on marginal costs for future proceedings.

After a careful review of the evidentiary record, *Residential Rates,* we will adopt the staff's recommendation to eliminate various density zone rates and consolidate domestic Schedules Nos. D-1 through D-5 into one Schedule No. D-1. This is done to simplify PG&E's rate structure and enable the public to understand information disseminated about electric rate design and how conservation will affect their electric bills. Further, by establishing a uniform $1.75 per month fixed domestic customer charge, we can price units of energy use so that utility bills are usage sensitive. These objectives are very much in the public interest as California and the nation move toward a conservation oriented energy ethic.[9]

[9] We note that density zone rates were historically supposed to be cost of service related. However, the record reflects that it tends to cost PG&E more to serve Zone D-1 (with the highest density) and Zone D-5 than it does Zones 2, 3, and 4 (Exhibit 74, p. 4-2 and related testimony). Thus, San Francisco's contention that existing density zone rates should be retained because they are cost of service related does not have merit.

We agree with staff testimony that the bill formats for PG&E should be revised to provide sufficient information to enable customers to readily follow the calculation of their bills. The bill should, at a minimum, separate the customer's monthly charge from the commodity charge so that the customer is aware of the price being paid for increased usage. This is especially pertinent for residential customers although the concept of providing sufficient information is applicable to all customer classes.

Lifeline Rates

Consistent with the policy discussed above, we will eliminate residential nonlifeline declining block rates and establish one uniform flat rate above the lifeline quantity which is higher than the lifeline rate to encourage conservation. Also, we find it is reasonable to simplify lifeline commodity rates which now vary with existing zones and establish one uniform lifeline rate. We also will eliminate existing declining block lifeline quantity rates.

The staff's proposed air conditioning allowance for two climate areas is reasonable and will be adopted. However, the months for which the rate will apply will be extended from the staff's recommended period of June through September to May through October to be consistent with our recent Decision No. 88651 (Lifeline Investigation, Phase II).

The rate effect of consolidating lifeline rates will result in base rate increases to some lifeline customers. These particular increases cannot be offset by ECAC reductions because ECAC reductions are being applied only to nonlifeline usage.

The following tabulation compares our adopted domestic base and ECAC rates with the rates in effect at the date of this decision. The following Table E-1 shows how the

increases compare to the presently effective rates authorized for electric department jurisdiction operations:

Table E-1

Present Schedule No.	Lifeline Allowance	Monthly kWh Usage	$ At Present Rates	$ At Adopted Rates	Increase $	Increase %
D-1	240	240	7.62	7.89	0.27	3.5
		300	10.16	10.50	.34	3.3
		500	19.32	19.18	(.14)	(.7)
		1,000	42.21	40.89	(1.32)	(3.1)
		1,290	55.49	53.48	(2.01)	(3.6)
		1,500	65.11	62.60	(2.51)	(3.9)
		2,000	88.00	84.31	(3.69)	(4.2)
D-1	1040	240	7.62	7.89	.27	3.5
		300	9.14	9.43	.29	3.2
		500	13.92	14.55	.63	4.5
		1,000	25.86	27.35	1.49	5.8
		1,290	38.26	39.23	.97	2.5
		1,500	47.88	48.35	.47	1.0
		2,000	70.77	70.06	(.71)	(1.0)
D-5	240	240	9.08	7.89	(1.19)	(13.1)
		300	11.86	10.50	(1.36)	(11.5)
		500	21.13	19.18	(1.95)	(9.2)
		1,000	44.03	40.89	(3.14)	(7.1)
		1,290	57.31	53.48	(3.83)	(6.7)
		1,500	66.92	62.60	(4.32)	(6.5)
		2,000	89.82	84.31	(5.51)	(6.1)
D-5	1040	240	9.08	7.89	(1.19)	(13.1)
		300	10.84	9.43	(1.41)	(13.0)
		500	16.74	14.55	(2.19)	(13.1)
		1,000	28.68	27.35	(1.33)	(4.6)
		1,290	41.08	39.23	(1.85)	(4.5)
		1,500	50.70	48.35	(2.35)	(4.6)
		2,000	73.59	70.06	(3.53)	(4.8)

(*Negative Amount*)

Medium and Large Light and Power Demand Charges

Presently under Schedules Nos. A-12 and A-13 of the medium and large light and power categories, respectively,

the customer's bill is a function of his energy demand and commodity use. The billing demand charge depends on the customer's usage pattern. If use is concentrated (and the customer puts maximum demand on the utility's system capacity), the billing for demand increases. Those customers who have relatively low billing demand charges, but who may consume a relatively large quantity of energy, contribute toward a higher utility load factor.

As a customer's load factor increases, a larger portion of his use is spread over semi-peak and off-peak periods (thereby decreasing peak load and the utility's need for additional generating capacity). We believe the staff's proposed A-12 and A-13 rate schedules will encourage these customers to achieve a higher load factor. For example, Schedule No. A-13 customers who have a load factor of 14 percent or below will pay the highest rate, those with a load factor between 14 percent and 41 percent will pay a lower commodity rate, and those with a 41 percent plus load factor will pay the lowest commodity rate. We are of the opinion that it is reasonable to assume that the customer with a load factor of 14 percent or less is consuming almost all of the energy during peak periods. Also, we believe the charges in Schedules Nos. A-12 and A-13 ordered herein are consistent with our policy announced in Decision No. 85559, Case No. 9804, which is to eliminate declining block rates and encourage time-of-use pricing. In the meanwhile, these rates will be replaced over time by time-of-use rates as time-of-use metering is implemented for more and more customers. The rate structure we have adopted is in the time-of-use direction (as a load management measure) and will encourage non-peak use.

Small Light and Power

Neither PG&E nor the staff proposed simplification of the blocking or rate structure for small light and power customers served under Schedule No. A-1.

However, we believe we should make changes to Schedule No. A-1 similar to those adopted for domestic customers, and for substantially the same reasons. The existing multiple rate zones are eliminated, as are the present three declining blocks. The customer charge will be a uniform $1.75 per month and a uniform commodity rate of .03¢/kwh will be applied under the new consolidated Schedule No. A-1. These charges will result in an estimated test year base rate revenue reduction of $21.6 million. However, this reduction is reasonable to bring rates for these customers in line with those of other customers; traditionally, their rates have exceeded the unit rates of other classes of service. The following Table E-2 illustrates the change in typical customer bills resulting from our restructuring and ECAC reductions:

Table E-2

Pacific Gas and Electric Company
BILL COMPARISON

Monthly Usage kWh	$ At 4/1/78 Rates	$ Adopted A-1	Increase $	Increase %
	Present Schedule A-5 vs Adopted A-1			
100	10.29	6.95	(3.34)	(32.5)
300	26.88	17.36	(9.52)	(35.4)
500	43.47	27.77	(15.70)	(36.1)
800	68.35	43.37	(24.98)	(36.5)
1,000	82.34	53.78	(28.56)	(34.7)
1,500	117.31	79.80	(37.51)	(32.0)
3,000	207.22	157.84	(49.38)	(23.8)
6,000	372.04	313.93	(58.11)	(15.6)
	Present Schedule A-1 vs Adopted A-1			
100	7.79	6.95	(.84)	(10.8)
300	20.38	17.36	(3.02)	(14.8)
500	32.97	27.77	(5.20)	(15.8)
800	51.85	43.37	(8.48)	(16.4)
1,000	63.84	53.78	(10.06)	(15.8)
1,500	93.81	79.80	(14.01)	(14.9)
3,000	178.72	157.84	(20.88)	(11.7)
6,000	343.54	313.93	(29.61)	(8.6)

(*Negative Amount*)

Agricultural and Medium and Large Light and Power Rates

We will continue the multiple block rate structure to encourage higher load factors for these customers (pending implementation of time-of-use rates), while adjusting tail block rates so they will be at a more reasonable level for the customer who attains a high load factor.

For agricultural users we will adopt PG&E's proposal, which was supported by the staff, that consolidates seven existing demand charge blocks into one and which consolidates twenty-one energy rate blocks into three. The lower service and monthly horsepower change proposed by the staff is reasonable and will be adopted.

We continue to pursue rate incentives that are designed to reduce or shift PG&E's summer agricultural demand. Electricity for agricultural pumping places considerable demand on PG&E's summer generating capacity. Combined with air conditioner use during the warmest periods of the day, agricultural pumping significantly contributes to the highest peak demand days. Experimental time-of-use rates are now in effect and available to encourage off-peak agricultural pumping. We believe PG&E should be directed to advise all agricultural customers of the time-of-use rate availability. If demand for time-of-use metering exceeds immediate capacity, PG&E should give high priority to expanding the availability of agricultural time-of-use metering. In future proceedings we will consider the need for mandatory time-of-use rates for agricultural pumping.

The staff's recommendation for consolidating medium light and power schedules as described herein are adopted. Schedule No. A-17 will be retitled Schedule No. A-23.

Street Lighting Rates

PG&E proposed a painting charge for street lighting poles. Presently under Schedule No. LS-1 normal maintenance is performed by the utility. We conclude that street

lighting rates adequately cover utility costs for normal maintenance, and we will not adopt PG&E's proposal.

We will adopt some of PG&E's proposed changes to the special conditions of Schedule No. LS-1. It is reasonable to adopt a special charge when a customer orders service to be discontinued. Such a charge makes PG&E whole for service discontinuance expense and, to a small extent, contributes some return for its investment in the facilities, which during disconnection will produce no revenue.

We approved lower rates when company-owned incandescent and mercury vapor lamps are converted to high pressure sodium vapor (HPSV) lamps, PG&E Advice Letter No. 669-E, filed May 5, 1978. Those rates will reduce the bills of customers served under Schedules Nos. LS-1 and OL-1, and it is reasonable to adopt that rate as the base rate for HPSV lamps. The staff recommends higher rates for incandescent and mercury vapor lamps, and we believe the rates for those lamps should be higher to encourage conversion to more efficient HPSV in the interest of promoting energy conservation.

PG&E's recommendation, which the staff supported, to modify traffic control Schedule No. TC-1 is reasonable and will be adopted. However, the commodity rate will be lowered to the level adopted for the new consolidated Schedule No. A-1 (see preceding discussion on small light and power rates). That reduction brings these rates into line with other rates, as recommended by the city of Oakland.

The following Table E-3 illustrates how the adopted rate design will generate the electric department's revenue requirement.

Line No.	Customer Class	Adjusted for % Discounts Sales GWhr [2]	Base Revenue $M [2] at 1/1/78	ECAC + FCB Revenue $M at 4/1/78
		(A)	(B)	(C)
	Residentials			
1	Lifeline	8,707	$ 209,242	$ 83,239
2	Non-Lifeline	9.651	189,930	250,897
3	Total Residential	18,358	399,172	334,136
	Light & Power			
4	Small	4,398	160,081	116,503
5	Medium	11,744	246,009	311,099
6	Large	13,374	176,448	354,277
7	Total Light & Power	29,516	582,538	781,879
8	Public Authority*	2,233	4,267	7,417
9	Agricultural	3,714	73,084	98,384
10	Street Lighting	503	22,255	13,324
11	Railway	266	2,494	7,046
	Interdepartmental			
12	Construction & Clearance	35	792	927
13	Other Operations	103	2,138	2,728
14	Total Interdepartmental	138	2,930	3,655
15	Subtotal	—	1,086,740	1,245,841
16	Other Operating Revenues	—	33,827	33,827
17	Total CPUC	54,728	1,120,567	1,279,668

* Proportional adjustment as authorized in contracts.

[1] Includes revenue decrease due to air-conditioning allowance.

[2] PG&E Exhibit No. 96, p. A-3.

Table E-3

Pacific Gas and Electric Company
Electric Department

1978 ADOPTED SALES AND REVENUE

Total Revenue $M at 4/1/78	Total Rate ¢/kWh 4/1/78	Base Revenue Increase $M	Base Revenue Increase ¢/kWh	ECAC Revenue Increase $M	ECAC Revenue Increase ¢/kWh	Net Change in Revenue $M	Net Change in Revenue ¢/kWh	Total Revenue $M	Total Average Rate ¢/kWh
(D)	(E)	(F)	(G)	(H)	(I)	(J)	(K)	(L)	(M)
$ 292,481	3.359	$(1,307)	(0.015)	$ (0)	—	$ (1,307)	(0.015)	$ 291,174	3.344
440,827	4.568	1,307	.014	(46,876) [1]	(0.486)	(45,569)	(.472)	395,258	4.096
733,308	3.994	0	0	(46,876)	(.255)	(46,876)	(.255)	686,432	3.739
276,584	6.289	(21,551)	(.490)	(19,615)	(.446)	(41,166)	(.936)	235,418	5.353
577,108	4.744	26,991	.230	(52,378)	(.446)	(25,387)	(.216)	531,721	4.528
530,725	3.968	27,062	.202	(59,648)	(.446)	(32,586)	(.244)	498,139	3.725
1,364,417	4.623	32,502	.110	(131,641)	(.446)	(99,139)	(.336)	1,265,278	4.287
11,684	4.173	564	.201	(1,249)	(.446)	(685)	(.245)	10,999	3.928
171,468	4.617	3,493	.094	(16,564)	(.446)	(13,071)	(.352)	158,397	4.265
35,579	7.073	1,686	.335	(2,243)	(.446)	(557)	(.111)	35,022	6.963
9,540	3.586	524	.197	(1,186)	(.446)	(662)	(.249)	8,878	3.338
1,719	4.911	92	.263	(156)	(.446)	(64)	(.183)	1,655	4.729
4,866	4.724	233	.226	(459)	(.446)	(226)	(.219)	4,640	4.505
6,585	4.772	325	.236	(615)	(.446)	(290)	(.210)	6,295	4.562
2,332,581	4.420	39,094	.074	(200,374)	(.380)	(161,280)	(.306)	2,171,301	4.114
33,827	—	94	—	—	—	94	—	33,921	—
2,366,408	4.420	39,188	.074	(200,374)	(.380)	(161,186)	(.306)	2,205,222	4.114

(Negative Figure)

Findings

1. A reasonable return on PG&E's estimated 1978 total common equity is 12.83 percent.

2. A 12.83 percent return on total common equity results in a 9.50 percent rate of return to be applied to the rate bases of PG&E's electric department (California jurisdictional) and gas department.

3. In Decision No. 86281 we proposed that all expenses of the applicant's Diablo Canyon nuclear projects be excluded in the adopted test year and be considered in a separate Diablo rate base offset proceeding. The Operations Division's staff results of operation in this proceeding excluding all costs related to Diablo Canyon including interest deductions and ad valorem taxes (both for book and as income tax deductions), and investment tax credit progress payments is reasonable and consistent with our prior Decision No. 86281. Further, it is reasonable that at the time of inclusion of Diablo Canyon in rate base the proper treatment of all investment tax credits, including progress payments, will be considered (and the recorded book value of the facility will be appropriately adjusted).

4. The estimated adopted test year results of operations for PG&E's gas and electric departments, as set forth in Tables I, II-A, and II-B in the body of this opinion, are reasonable.

5. To have an opportunity to earn its authorized rate of return for the electric department, PG&E needs an annual income in gross revenue requirement in the amount of $39,188,000, excluding ECAC revenues.

6. To have an opportunity to earn its authorized rate of return for the gas department, PG&E needs an annual increase in gross revenue requirement in the amount of $99,329,000.

7. PG&E has included, and the Commission has adopted, $4.7 million test year conservation expense for customer incentives (water heater blankets and shower heads). Those incentive programs should be implemented now, subject to modification or termination after the rehearing of Decision No. 88551, Case No. 10032.

8. PG&E's conservation efforts, while not as vigorous and imaginative as they could be, are adequate and a rate of return reduction is not warranted.

9. In Decision No. 84902 we said: "We expect utilities to explore all feasible cost-effective means of conservation, including . . . providing customers with detailed, intelligible information on appliance energy use by brand name ('Shoppers Guide') . . ." PG&E has distributed this information only to appliance dealers and customers specifically requesting it.

10. PG&E needs to review all its options for repowering existing generating facilities (including hydroelectric plants), expanding facility modification and maintenance efforts that can improve generating efficiency and reliability.

11. PG&E needs to review and catalog all auxiliary power and cogeneration sources in its service area and determine their availability and potential to contribute power during PG&E's highest demand periods.

12. PG&E needs to prepare future electricity supply and investment plans for a period of a minimum of 20 years.

13. It is reasonable and in the public interest to direct PG&E to undertake a management audit. The Commission should approve the scope of the management audit.

14. The proposal of Southwest and Palo Alto (resale customers of PG&E) that their respective resale rates be adjusted to exclude PG&E's conservation expense is not in the public interest. PG&E's conservation efforts benefit

these resale customers (and ultimately their customers) as well as all California energy utility customers.

15. Gas rate design proposals submitted by Kerr-McGee and CMA, emphasizing high fixed monthly customer charges, are inconsistent with a conservation oriented rate design, which places emphasis on pricing units of energy use to give customers a clear economic message that conservation equates to significant utility bill savings.

16. It is reasonable to establish Palo Alto's rate (Schedule No. G-60), so that Palo Alto has a $0.0458/therm differential above the cost of purchased gas on every dollar of sales, using PG&E's general service rates as a basis for determining Palo Alto's revenue.

17. The gas rates authorized in Appendix B hereto are reasonable.

18. The electric rates authorized in Appendix C hereto are reasonable.

19. Marginal cost based rates promote the more efficient use of resources and provide more accurate price signals to consumers. The utility and the staff should increase their efforts in developing marginal costs and rates based on marginal costs.

20. There is a need for PG&E to pursue rate incentives that are designed to reduce or shift PG&E's summer agricultural customer electricity demand.

21. PG&E should undertake a revision of its current billing formats in order to ensure that customers are provided with all of the information necessary to allow them to understand the calculation of their bills.

22. It is reasonable to make the base rate increases authorized herein conditional on PG&E's concurrently making effective rate reductions resulting from recently adopted Article XIII-A of the California Constitution (Proposition 13). PG&E has filed Advice Letters Nos.

106-G and 687-E estimating reduced cost of service in the amount of $17,740,000 for its gas department and $43,876,000 for its electric department. PG&E has established a tax initiative balancing account pursuant to our OII No. 19.

23. All pending motions taken under submission and not ruled on should be denied.

24. The following order should be effective the date of signature because there is an immediate need for rate relief.

Conclusions

1. PG&E should be authorized to file revised gas rates as set forth in Appendix B, which are designed to:

a. Produce $99,329,000 in additional revenues based on 1978 test year adopted results of operation.

b. Produce $90,300,000 in additional revenues to compensate for increased purchased gas expense, pursuant to Decision No. 89317 in Application No. 57978.

PG&E should, concurrently effective with the above increases, reduce gas rates by $17,740,000 annually (pursuant to PG&E's Advice Letter No. 106-G) to pass on the estimated benefits of Article XIII-A of the California Constitution to consumers.

PG&E should file within 60 days in Case No. 10032 contingency plans for alternate conservation activities in the event customer incentive conservation programs are not approved after rehearing of Decision No. 88551.

2. PG&E should be authorized to adjust electric rates as set forth in Appendix C, which are designed to do the following:

a. Increase base rates by $39,188,000 based on test year 1978 adopted results of operation.

b. Reduce ECAC rates by $208,577,000, pursuant to Decision No. 89318 in Application No. 58033.

PG&E should, concurrently effective with the above increases, reduce electric rates by $43,876,000, pursuant to its Advice Letter No. 687-E, to pass on the estimated benefits of Article XIII-A of the California Constitution (Proposition 13).

3. PG&E should be directed to review and study options for resource planning.

4. PG&E should be directed to undertake a management audit under the supervision of the Commission staff.

5. PG&E should be directed to distribute a "Shopper's Guide" comparing the efficiency of domestic electric refrigerator units.

6. Electric rates authorized to be collected subject to refund in Decision No. 88262, Application No. 57289, should no longer be collected subject to refund.

ORDER

IT IS ORDERED that:

1. Pacific Gas and Electric Company (PG&E) shall review all its options for repowering existing generating facilities (including hydroelectric plants) and for expanded facility modification and maintenance efforts that can improve efficiency and reliability. PG&E shall also assess the cost-effectiveness of these options. PG&E shall report to the Commission on its findings within one hundred eighty days from the date of this order with a progress report after ninety days. PG&E's efforts along these lines will be reviewed in an investigation being instituted concurrently with this decision. PG&E shall further proceed to implement all cost-effective maintenance programs as soon as possible after completing this review and shall incorporate

all cost-effective repowering options into its resource plan or justify to this Commission its decision for not doing so.

2. PG&E shall review and catalog all existing auxiliary power sources in its service area and all potential future auxiliary power and cogeneration projects and their availability to contibute power during its high demand periods. This review shall include an assessment of the economics, institutional arrangements, maintenance and fuel requirements, and possible cost-effective incentives necessary to enable it to call upon such auxiliary facilities as peaking capacity for its system. PG&E shall report to the Commission on its findings within one hundred eighty days from the date of this order with a progress report after ninety days.

3. PG&E shall, by April 15, 1979, prepare and submit a twenty-year electric supply plan reflecting energy conservation and all cost-effective alternate sources of energy. Complete information should be provided on loads and resources, estimated capital and operating costs, and financial and rate impacts for each year of the twenty-year period.

4. PG&E shall undertake a management audit, conducted by independent consultants. Before consulting contracts are awarded and the audit is begun, the Executive Director shall submit to the Commission, for its approval, the specific areas of inquiry the management audit will cover.

5. PG&E shall advise, within sixty days from the date of this order, all customers who are eligible for experimental time-of-use rates for agricultural pumping of the availability of such time-of-use rates, if PG&E cannot provide time-of-use metering facilities to all eligible agricultural customers requesting such facilities by February 1, 1979, it shall advise the Commission the reasons why it cannot. PG&E is directed to give high priority to implementing time-of-use rates for agricultural customers. And if PG&E cannot provide such facilities to all agricultural customers

requiring it by February 1, 1979, it shall explain the measures it is taking to give this undertaking high priority.

6. PG&E shall distribute, at least once every 18 months, to each of its residential customers a brochure listing energy efficient refrigerators, freezers, and refrigerator-freezer combinations. The brochure shall compare appliances with similar features, listing specific information by brand name, model, size in cubic feet, kilowatt-hour usage per month, and average estimated annual operating cost. The first distribution of this brochure shall be made within ninety days from the effective date of this order.

7. PG&E shall, in consultation with the staff, undertake to revise its bill formats in such manner as is directed by the staff. The revised formats shall provide customers with the information necessary for an understanding of the bill calculation.

8. PG&E shall advise all agricultural electric customers of the availability of time-of-use rates. PG&E shall furthermore give high priority to expansion of time-of-use rates and metering for agricultural electric customers.

9. PG&E is authorized to immediately implement its insulation incentive programs as planned.

10. PG&E is hereby directed to file within sixty days, in Case No. 10032, contingency plans for alternate conservation activities, with expenses budgeted at an annual rate of $4.7 million in the event that incentive programs are terminated upon rehearing of Decision No. 88551.

11. PG&E is authorized to file with this Commission revised schedules for gas and electric rates as set forth in Appendices B and C hereto on or after the effective date of this order. The revised tariff schedules shall become effective five days after filing. The increase in base rates authorized herein is conditioned on PG&E's concurrently filing tariff schedules making the reductions it proposed in

its Advice Letters Nos. 106-G and 687-E, reducing nonlifeline gas rates on an equal cents-per-therm basis by $17,740,000 annually and nonlifeline electric rates on an equal cents-per-kilowatt-hour basis by $43,876,000.

12. All motions in these proceedings not heretofore ruled on are denied.

13. Electric rates collected subject to refund pursuant to Decision No. 88262, Application No. 57289, shall no longer be collected subject to refund.

The effective date of this order is the date hereof.

Dated at San Francisco, California, this 6th day of September, 1978.

ROBERT BATINOVICH
President
VERNON L. STURGEON
RICHARD D. GRAVELLE
CLAIRE T. DEDRICK
Commissioners

I will file a dissent.

/s/ WILLIAM SYMONS, JR.
Commissioner

I will file a written concurrence.

/s/ VERNON L. STURGEON
Commissioner

Appendix A

LIST OF APPEARANCES

Applicant: *Malcolm H. Furbush,* Robert Ohlbach, and William H. Edwards, Attorneys at Law, for Pacific Gas and Electric Company.

Protestants: Mike Franey, for Concerned Consumer Committee; *Rev. Fred Wilken,* for Consumers Protective Service; *Cherylyn Smith,* for People for Safe Energy; and *Shendl Tuchman,* for People Against Nuclear Power.

Interested Parties: Thomas M. O'Connor, City Attorney, by *Leonard L. Snaider,* Deputy City Attorney, and Robert R. Laughead, P.E., for City and County of San Francisco; *Glen J. Sullivan,* Attorney at Law, for the California Farm Bureau Federation; *Gordon E. Davis* and William H. Booth, Attorneys at Law, for California Manufacturers Association; *Susan L. Paulus,* Attorney at Law, for Owens-Corning Fiberglas Corporation; *John G. Lyons,* Attorney at Law, for Stuart Morshead; *David B. Roe,* Thomas J. Graff, and Christopher H. Schroeder, Attorneys at Law, for the Environmental Defense Fund; *Robert Spertus* and David Tishman, Attorneys at Law, and Sylvia Siegel, for TURN; *Henry R. MacNicholas,* Attorney at Law, for Airco, Inc.; *Earl R. Sample,* for Southern California Edison Company; *William L. Knecht,* Attorney at Law, for California Association of Utility Shareholders; *Georges H. Shers,* H. W. Carmack, and Dick Urbanick, for City of Oakland; *John L. Mathews,* Attorney at Law, for the Executive Agencies of the United States; Anne Mester and *Jonathan Blees,* Attorneys at Law, for California State Energy Resources Conservation and Development Commission; *Scott A. Stephens,* for Building Owners & Managers Association; *Randy Baldschun* and Marilyn Norek Taketa, Attorney at Law, for City of Palo Alto; *Boris H. Lakusta,* David J. Marchant, and Jerry J. Suich, Attorneys at Law, for California Hotel & Motel Association, Western Mobilehome

Association, and Collier Carbon & Chemical Corporation; *Allen B. Wagner,* Attorney at Law, and Harry Winters, for The Regents of the University of California; *James P. Bennett,* Attorney at Law, for Kerr-McGee Chemical Corporation; *Thomas S. Knox* and William Bogaard, Attorneys at Law, for California Retailers Association; *Philip A. Stohr* and Richard R. Gray, Attorneys at Law, for General Motors Corporation; *Peter Kuhn,* for himself; and *Richard D. DeLuce,* Attorney at Law, for Air Products & Chemicals, Inc.

Commission Staff: *James S. Rood, Mary Carlos,* and *Jasper Williams,* Attorneys at Law, *Martin Abramson,* P.E., *John D. Quinley,* P.E., and *Kenneth Chew,* C.P.A.

Appendix B

[To the Decision]

GAS RATES

2 pages—Omitted in printing

• • • •

Appendix C

[To the Decision]

RATES—ELECTRIC DEPARTMENT

17 pages—Omitted in printing

Decision on General Rate Increase Application of Pacific Gas and Electric Company

COMMISSIONER WILLIAM SYMONS, JR., Dissenting.

Government is supposed to house disinterested officials "who see the big picture" and respond by long range planning. Too frequently, however, Government houses the fellows with their eyes on the next election. So the planning is really short-run—to get by the next two years or the next two months. Recently, in its energy utility decisions, the California Public Utilities Commission has employed gimmickry and short-run considerations to an unbelievable extent. Unfortunately, today's order carries on in the same vein.

The tragic harm caused by regulation for the short-run is often unnoticed until much later, when the decision-makers have moved on, and John Q. Citizen is left holding the bag. This must not happen in California.

I

The Commission Evades Problems in Gas Pricing Which Have Reached Crisis Proportions.

The most critical failure in today's decision is the Commission's "band-aid" non-solution to the severe crisis caused by last year's surprise restructuring of natural gas prices (D. 87585, July 12, 1977).

Examine the most important portion of today's general order, that is, the changes in base rates. The big changes have been in gas. (Changes on the electric side, due to ECAC are large, but not as significant. Rates are lowered as they were raised, therefore, not changing rate structure). The following table identifies the changes in PG&E's

rates. It can be seen that the "big dollar" changes in base rates occur in natural gas:

	BASE RATE CHANGES	ECAC CHANGES	CHANGES Attributable to Prop. 13	CHANGES Postponed Until January 1, 1979
GAS	$190 Million Increase		$18 Million Decrease	Approximately $38 Million Increase; to be Postponed to next GCAC
ELECTRIC	$39 Million Increase	$209 Million Decrease due to End of Drought	$44 Million Decrease	

To issue this general rate case, but evade the severe gas problem, is bad regulation. General rate cases are infrequent but important. The general rate case is characterized by broad participation and full issue investigation. For this reason, the general rate case decision is the proper vehicle to correct serious problems recognized to be building up in the system.

In PG&E's case, it is apparent from the record that the Commission's hasty and ill-conceived rate redesign of last summer has had severe detrimental effects on the company, the customers, and the economy. Rates that commerce and business must pay are now among the highest and most unfair in the country. These are rates which deter relocation of new industry and jobs to California. These rates competitively disadvantage existing California producers. They are rates which force inflation in consumer prices.

Social ratemaking schemes of the past two years and lifeline overruns have so distorted rates in California that disbursing less-than-cost energy is wide spread and common. To compensate, prices to remaining customers have been jacked-up enormously. These prohibitively high rates have caused a substantial segment of PG&E's historical customers to use alternate fuel and prematurely leave the system. An unheard-of-gas glut has developed in California. Underground storage has been stuffed to historical highs.[1] A revenue crisis for the utility resulted.

California already is attracting notoriety for its oddball rates:

> "In brief, the subsidy to lifeline users of natural gas approaches incredibility. For PG&E, cost-of-service studies on the peak month basis introduced into a 1978 rate case show large industry paying rates for natural gas which equate to a 42 per cent rate of return on natural gas sales to the residential class is minus 2 per cent".[2]
>
> "The original intent of 'lifeline rates' in California is so deformed that it reminds one of the adage: 'Nothing is worthless, it can serve as a horrible example.' "[3]

---

[1] A.57978 TR Vol. 1, p 56. The Volume of gas in storage for PG&E at the beginning of the summer period (when storage usually *begins*), July 1, 1978, stood at 170 billion cubic feet; 70% above PG&E's own storage capacity. PG&E has made additional arrangements for storage. PG&E estimates deliveries exceeding sales such as to cause storage to reach 211 billion cubic feet by December 1979. (Vol. 1, pg 95). This approximates nearly one half of the annually gas supply received from Canadian sources.

[2] "California's Lifeline Policy", Dr. Albin J. Dahl, *Public Utilities Fortnightly*, Aug. 31, 1978, p. 20.

[3] "Utility Rates under the National Energy Act, Quo Vadis," Daniel J. Reed, *Public Utilities Fortnightly*, July 20, 1978, p. 12.

Consistent with the record developed in this case, as well as the evidence incorporated from companion hearings in A.58078, the Commission needs to undertake immediate restructuring of rates with a reallocation of revenue requirements to effect parity with cost of service. California needs a return to sanity in gas pricing.

Instead, the Commission cynically avoids coming to grips with the crisis, allowing this malignancy to fester and grow. This continues in the unsavory practice of the past year: put off the day-of-reckoning as long as possible.

The Commission grasps one expedient after another:

1) First, $52.4 million in refunds due PG&E customers were expropriated. Instead of being refunded, the money was used to defer rate changes and buy gas in 1978. (D. 88261, Dec. 20, 1977). Those monies are now nearly exhausted.

2) Next, the CPUC tried to stop the loss in sales by conspiring with the Air Resources Board to require large customers to buy gas regardless of price. That course raised such a furor that it has been shelved for the time being.

3) The CPUC replaced the mechanism of the "PGA" (Purchased Gas Adjustment) with a "GCAC", (Gas Cost Adjustment Clause). The PGA is an offset procedure. Costs and rates rise simultaneously. The PGA is designed to match cost of gas increases with increased revenue rates so there is no lag time.

The new GCAC is a recorded system. It uses an accounting accrual method. Undercollection will be accrued to be repaid with rate increases at a future date. $38 million in gas rate increases are thus postponed till the new year.

4) The CPUC seizes upon property tax reductions that may occur in 1979 and uses them now. (This mechanism for premature application of tax reductions is discussed in detail later).

5) In its series of non-solutions, the Commission next concocted what must appear to consumers as the regulatory equivalent of the "Death Star". It's name is "S.A.M." The Commission's starting "Supply Adjustment Mechanism" insulates utilities (but not customers) from the effects of the precipitous fall-off in gas sales. (D. 88835, May 1, 1978). S.A.M. guarantees the companies a margin on sales, whether sales are made or not. The money to make the utilities whole in the case of non-sales will come from adding a S.A.M. surcharge to customers bills. An increase as large as $85 million dollars for PG&E was foreseen to begin with the new year.

Today's decision goes an extreme further:

6) The Commission establishes discriminatory pricing *within* a class of similar customers. The old G-50 schedule for P-3 and P-4 customers is split. 29% of the customers form a new group: G-52. The new G-52 customers are to be charged a cheaper gas rate even though they use the gas for identically the same use as the remaining G-50 customers. The only operative distinction is between the "haves" and the "have-nots". Customers *with* capability to use alternate fuels Numbers 5 and 6 are treated to the lower rates of 22.9¢/therm. Customers *without,* are "treated" to a rate *increase* of 25.2¢/therm. As numerous parties to the record and the staff indicate, there is no reasonable basis to justify this discrimination. It is as wrong as if the PUC had ordered fares for bus service lower to a man who owns a car, and higher to a man without one. When we regulate monopolies, our first duty under the CPUC Code is to prevent discrimination among customers—not to establish it.

I have two other comments on today's gas rate changes: First, it is unlikely that the discriminatory G-52 rate will effect a solution to the lost revenue problem because the Commission only sets the scheme halfway into operation.

PG&E filed for a 20¢/therm rate. PG&E's survey shows that P-3 and P-4 customers able to switch to Number 6 fuel purchase account for 36 billion cubic feet in gas sales annually. At 22.9¢/therm expected loss in sales is 24 billion cubic feet. At 20¢/therm only 9 billion cubic feet of sales was predicted to be lost. The selection of the 22.9¢/therm figure by the PUC makes the success its "G-52 solution" questionable. If the "G-52 solution" fails to reverse the fall-off in sales the remaining customers can expect *S.A.M. surcharge* beginning the new year to be considerably *increased.*

Second, I note that lifeline rates have been raised from 14.2¢ to 16.5¢/therm. I do not think this fact alone justifies us to proclaim that the majority has finally seen the light. With such an extremely over-burdened non-residential class there is really very little choice left to the majority as to where to place these rate increases. One should soberly note that the average commodity charge for gas has risen substantially over the last two years. The increased lifeline charge of 16.5¢ is still substantially below the 18¢/therm system average commodity cost of gas. 60% of residential gas is sold at these less-than-cost lifeline rates. So one realizes that the enormous subsidy burden of massive welfare still weighs too heavily down upon the system.

II

The Electric Base Rate Increase Is Not Disbributed [sic] Equitably.

Today's order grants $39 million in base rate increases. This is an overall 3% system increase, yet:

— residential goes up 0%
— agricultural goes up 5%
— there is 7% relief to small light and power
— medium light and power goes up 11% or $27 million
— large light and power goes up 15%, also $27 million. *This is 5 times the system average rate increase.*

Such a pattern of rate increases completely ignores cost-of-service. It ignores the punitively high rate of return already paid by large business and industry. Such heavy-handed discrimination only further harms an already ailing California business climate.

I am additionally distressed to see lifeline extended to air conditioning. This extension fails to meet the normal test of "paying one's own way". It also subsidizes useage [sic] which occurs at *annual system peak,* when costs are highest. How can the Commission reconcile this with its goals of minimizing utility costs? Of discouraging peak use? Or of maximizing conservation?

III

Today's 12.83% Rate of Return is Too Low.

Adequate return on investment, in layman's terms, is the gas that makes the car go. Low quality return on utility investment means future service to Northern California customers will be characterized by fits and starts. The ratepayer will pay more in the long run in two ways: first, as financial ratings decline, costs of credit rise. Second, as uncertainty is introduced into the company's expansion plans, individual plans for business expansion are made uncertain. Instability and unpredictability in energy-supply chill the state's economy and harm the job market.

PG&E's last offering of common stock occurred in November, 1977. As has become the norm with PUC-regulated utilities, the stock sold for well below book: $23⅝ per share, versus a book value of $28⅞. This chronic situation calls for immediate rectification in the form of a higher return and consequent enhanced financial health.

A higher return will also make PG&E's stock more attractive in a period of almost double digit inflation. We must recall that in the late 1960's, when inflation was not

nearly the problem it is today, the Commission permitted PG&E to earn an average return on common of 11.5-12%. Clearly, the late 1970's call for more than that.

We must also reverse the slide in PG&E's financial rating. Two years ago, its preferred stock was downgraded from Aa to A; its bonds downgraded from "Aa" to "Aa—". This means higher capital costs to a company which must consistently be in the financial market. Yet I see nothing in today's order which will reverse this trend or put PG&E in a better position when it seeks credit.

IV

Today's decision deducts potential proposition 13 reductions prematurely.

By adding $62 million in Proposition 13 reductions to $209 million in ECAC reductions, the Commission is able to publicize this *major base rate increase of $229 million* ($190 Gas, $39 Electric) as a $41 million rate deduction.

A Proposition 13 deduction is clearly premature for three reasons:

1) The Commission's Order Instituting Investigation on Proposition 13 reductions (OII 19) is still underway. No finding as to the proper amount of tax reductions has been made, $60 million or otherwise.

2) The constitutionality of Proposition 13 is in active court litigation. Oral and written arguments have been made before our California Supreme Court. A decision is pending.

3) Utilities have filed income tax returns for past years which utilize special IRS tax lien provisions. Under the terms of IRS provisions PG&E is precluded from receiving any Proposition 13 tax savings for the year 1978. The tax effects will begin in 1979. The reductions should be timed for 1979 to

coincide with the decreases. This is customary regulatory practice.

V

"Time of Use" Rates Should Not be Imposed on California Agriculture.

This is a hair-brained concept which shows ignorance of controlling factors for farm irrigation: the crops, the soil, and the weather. These require California farmers to operate around the clock. Forced "time of use" rates for agriculture would greatly harm our state's number one industry. Mandatory "time of use" rates for agriculture is one camel's nose that should not be allowed under the tent.

/s/ William Symons, Jr.
WILLIAM SYMONS, JR.
Commissioner

San Francisco, California
September 11, 1978

COMMISSIONER VERNON L. STURGEON, Concurring

I had hoped that this Commission today would continue taking forward steps in utility regulation, this time by allowing an appropriate return on stockholder equity. The Commission has taken some positive and innovative regulatory steps in the last two or three months that I heartily endorse. Today we took one step sidewise. An allowance of 12.83% is simply not enough, in my judgment, to attract new investors to PGandE stock.

In every case that this Commission issues wherein rate of return is discussed, a long litany of considered items is recited. At the end of this regulatory smog the Commission always announces its continued belief that return on equity is a matter of informed judgment. And so it should be. What seems to get lost in this Commission's consideration of equity allowance, is the fact that the money marketplace in which PGandE and other California utilities must compete for capital is indeed a free marketplace. Investors have a multitude of choices; for example, they can deal in land, commodities, industrial stocks, municipal bonds, utility stocks and bonds, or anything else that appeals to them in or out of the securities market. Investors must be attracted by some prospect of gain. Investors can't be forced to invest. It is the duty of this Commission to set a return at a level which will attract investors.

PGandE faces an immense future financing burden and will need much new investment. This is a burden which we approve. The construction that faces PGandE is a function of the fact that California is a great state and its economy is a powerful machine and the needs of PGandE's customers absolutely must be met. PGandE simply cannot raise the quantities of capital it will need, at a decent price, if this Commission continues to establish an equity return that investors find unappealing. It means that when PGandE does succeed in attracting an investor, the rate-

payers of California will be forced to pay a higher price for the rent of that money than would be the case with an adequate return allowance. A low return on equity is short-sighted thinking that penalizes future ratepayers. 12.83% is too low today.

What did PGand E ask for? 15%. Our Staff, low as always, recommended 12.77%. Recommendations of other parties to the case ranged from 12% to almost 16%. The 12.83% allowed is simply a regurgitation of the PGandE existing equity allowance as if nothing had happened in the world since their last rate case.

If California means business, California must have regulatory decisions that reflect the drives and aspirations of its people. Timidity didn't build California. People who could take the long view built this state. A few more are needed here today. This Commission should recognize that a slightly higher equity allowance today will mean lower financing costs for years to come. Believing that, California regulators must be strong enough to act accordingly. 13% or more has been recognized as appropriate equity level for energy utilities in at least thirty states. Alabama has. Arizona has. Arkansas has. Colorado has. Connecticut has. And on and on and on, including New York, Pennsylvania, Illinois, Massachusetts, Michigan, Ohio, Texas, Wisconsin, etc., etc. California energy utilities deserve at least as much. Investors demand as much.

I have one additional comment to make on today's order. The discussion on page 94 and in Finding 20 regarding time-of-use rates for agricultural pumping ignores the capabilities and economic practices of the real world of agriculture. As a matter of fact, agricultural irrigation pumping systems attain the highest efficiency when operating around the clock. Such operation minimizes waste of both water and energy. Therefore, adjusting the use of agricultural pumps to take advantage of time-of-use rates will not only increase waste, but will require monumental expenditures for additional wells, pumps and distribution systems. Any incentive or disincentive that were provided would be meaningless as far as conservation or peak-load capacity is concerned.

/s/ Vernon L. Sturgeon
VERNON L. STURGEON
Commissioner

San Francisco, California

September 6, 1978

APPENDIX C

Decision No. 89654 November 9, 1978

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application No. 57284

(Filed May 5, 1977; amended June 15, 1977)

Application of Pacific Gas and Electric Company for authority, among other things to increase its rates and charges for electric service.

(Electric)

Application No. 57285

(Filed May 5, 1977; amended June 15, 1977)

Application of Pacific Gas and Electric Company for authority, among other things to increase its rates and charges for gas service.

(Gas)

Order Denying Rehearing

Environmental Defense Fund, Toward Utility Rate Normalization, City and County of San Francisco, California Association of Utility Shareholders, Airco, Inc. and General Motors Corporation have filed petitions for rehearing of Decision No. 89316. The Commission has considered each and every allegation contained therein and is of the opinion that no good cause for granting rehearing has been shown.

Environmental Defense Fund has filed an Emergency Petition for Extension of Effective Date of Decision No. 89316, and Toward Utility Rate Normalization has filed a Petition for Immediate Suspension of Decision No. 89316.

The Commission has considered both petitions and is of the opinion that both petitions should be denied. Therefore,

IT IS ORDERED that rehearing of Decision No. 89316 is denied.

IT IS FURTHER ORDERED that the Emergency Petition for Extension of Effective Date of Decision No. 89316 filed by Environmental Defense Fund and the Petition for Immediate Suspension of Decision No. 89316 filed by Toward Utility Rate Normalization are denied.

The effective date of this order is the date hereof.

Dated at San Francisco, California, this 9th day of November, 1978.

ROBERT BATINOVICH
President
VERNON L. STURGEON
RICHARD D. GRAVELLE
CLAIRE T. DEDRICK
Commissioners

I dissent. I would
grant rehearing.
WILLIAM SYMONS, JR.

APPENDIX D

Notice of Appeal to The Supreme Court
of The United States

In The Supreme Court of the
State of California

CALIFORNIA ASSOCIATION OF UTILITY SHAREHOLDERS
(a corporation),
Appellant,

v.

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA and JOHN E. BRYSON, VERNON L. STURGEON, RICHARD D. GRAVELLE, CLAIRE T. DEDRICK, and LEONARD M. GRIMES, JR., the members of said Public Utilities Commission; THE PACIFIC GAS AND ELECTRIC COMPANY, a corporation
Appellees.

NOTICE IS HEREBY GIVEN THAT the above-named appellant California Association of Utility Shareholders hereby appeals to the Supreme Court of the United States from the final judgment of the Supreme Court of the State of California on July 19, 1979 affirming Decision No. 89316 dated September 6, 1978 and Decision No. 89654 dated November 9, 1978 of the Public Utilities Commission of the State of California.

This appeal is taken pursuant to Title 28, United States Code, Section 1257, subparagraph (2).

DATED: October 5, 1979

WILLIAM L. KNECHT
524 23rd Street
Oakland, California 94612

HOWARD C. ANDERSON
Dewey, Ballantine, Bushby,
Palmer & Wood
1775 Pennsylvania Avenue, N.W.
Washington, D.C. 20006

By /s/ WILLIAM L. KNECHT
Attorneys for Appellant
California Association of
Utility Shareholders

Certificate of Service

No. 79- October 5, 1979

I, William L. Knecht, a member of the Bar of the Supreme Court of the United States and an attorney for Appellant California Association of Utility Shareholders, hereby certify that I have served a copy of the foregoing notice upon the persons named below by depositing the same in a United States mail box, with first class postage prepaid, addressed to the following persons at their respective addresses appearing below.

JANICE E. KERR
HECTOR ANNINOS
RANDOLPH L. WU
5066 State Building
San Francisco, California 94102
Attorneys for the Public Utilities Commission of the State of California and for John E. Bryson, Vernon L. Sturgeon, Richard D. Gravelle, Claire T. Dedrick, and Leonard M. Grimes, Jr., the members of said Public Utilities Commission

MALCOLM H. FURBUSH
ROBERT OHLBACH
WILLIAM H. EDWARDS
Law Department
77 Beale Street
San Francisco, California 94106
Attorneys for The Pacific Gas and Electric Company

/s/ William L. Knecht
WILLIAM L. KNECHT
524 23rd Street
Oakland, California 94612

Supreme Court, U. S.
FILED
NOV 16 1979
MICHAEL RODAK, JR., CLERK

In the Supreme Court
OF THE
United States

OCTOBER TERM, 1979

No. 79-628

CALIFORNIA ASSOCIATION OF UTILITY SHAREHOLDERS
(a corporation),
Appellant,

vs.

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA and JOHN E. BRYSON, VERNON L. STURGEON, RICHARD D. GRAVELLE, CLAIRE T. DEDRICK, and LEONARD M. GRIMES, JR., the members of said Public Utilities Commission; THE PACIFIC GAS AND ELECTRIC COMPANY, a corporation,
Appellees.

On Appeal from the Supreme Court of the State of California

MOTION TO DISMISS

JANICE E. KERR
HECTOR ANNINOS
ANNE K. MESTER
RANDOLPH L. WU
5066 State Building
San Francisco, California 94102
(415) 557-0336
Attorneys for the Public Utilities Commission of the State of California

BOWNE-PERNAU WALSH • 1045 SANSOME ST. • S.F., CA 94111 • (415) 981-7882

In the Supreme Court
OF THE
United States

OCTOBER TERM, 1979

No. 79-628

CALIFORNIA ASSOCIATION OF UTILITY SHAREHOLDERS
(a corporation),
Appellant,

vs.

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA and JOHN E. BRYSON, VERNON L. STURGEON, RICHARD D. GRAVELLE, CLAIRE T. DEDRICK, and LEONARD M. GRIMES, JR., the members of said Public Utilities Commission; THE PACIFIC GAS AND ELECTRIC COMPANY, a corporation,
Appellees.

On Appeal from the Supreme Court of the State of California

MOTION TO DISMISS

The appellees (the Commission) move the Court to dismiss the appeal on the ground that the appeal does not present a substantial federal question. (Rule 16(1)(b) of the Rules of the Supreme Court of the United States).

I
OPINIONS BELOW

The opinions below are correctly stated in Appellant's (Shareholders') Jurisdictional Statement.[1]

II
JURISDICTION

Jurisdiction is asserted by Shareholders under Title 28, United States Code § 1257(2). (Jur. St. 2).

III
QUESTION PRESENTED

Did the Commission's action in adopting 12.83% as a fair and reasonable rate of return on equity for Pacific Gas and Electric Company (Company), constitute an abuse of discretion because it set confiscatory rates, thereby depriving Company's stockholders of their property without due process, in violation of the 14th Amendment of the United States Constitution?

IV
ARGUMENT

A. Shareholders Has Misstated the Question Presented by This Case

Shareholders asserts that the following federal question is presented: whether a state regulatory agency, having set rates designed to produce the rate of return required by law, and in so doing having allegedly unjustly disregarded

[1]References herein to appendices are to those attached to the Jurisdictional Statement. "Jur. St." followed by a number refers to pages of the text of the Jurisdictional Statement.

the effect of attrition on a utility's earnings, has violated the rights of the utility's stockholders under the Fourteenth Amendment to the United States Constitution by depriving them of their property without due process of law.

By stating the question in the above manner, Shareholders seeks to have this Court substitute its judgment for that of the Commission regarding calculation of a fair and reasonable rate of return for Company. That clearly is a role which this Court has declined to play. In suits involving the validity of rates fixed by a state commission, this Court will not sit as a board of revision, but will concern itself only with the question of whether constitutional rights have been violated. *Railroad Commission v. Pacific Gas & Electric Co.* (1938) 302 U.S. 388, 393, 394; *Los Angeles Gas & Electric Co. v. Railroad Commission* (1933) 289 U.S. 287, 304, 305. The only question present in this case is whether in the exercise of its rate-making authority, this Commission abused its discretion in such a way as to set confiscatory rates for Company, thereby depriving Company's stockholders of their property without due process of law. If the Commission did not abuse its discretion in setting rates, then no federal question remains to be answered.

B. Shareholders Has Not Sustained Its Burden of Proving That the Commission Adopted a Confiscatory Rate of Return

It is well settled that a decision of a state commission setting rates and adopting a rate of return for a public utility, which decision has been upheld by the highest court of the state, is presumed to be valid. One protesting such

a decision has a heavy burden of making a convincing showing that the decision is invalid because it is unreasonable and unjust. *Federal Power Commission v. Hope Natural Gas Company* (1944) 320 U.S. 591, 602; *Railroad Commission v. Pacific Gas & Electric Company, supra,* at 401. Shareholders has completely failed to make the required showing.

(1) Shareholders Erroneously Alleges That the Commission Did Not Meet the Standards Set Forth By the United States Supreme Court for Determining an Adequate Rate of Return

Shareholders contends that the Commission failed to abide by the Court's guidelines set forth in *Federal Power Commission v. Hope Natural Gas Company, supra,* and *Bluefield Waterworks and Improvement Co. v. West Virginia Public Service Commission* (1923) 262 U.S. 679, in adopting a rate of return for Company. (Jur. St. 17, 19, 20). Shareholders argues that the *Hope* and *Bluefield* cases require the Commission to take specific account of attrition when applying its rate-making formula. (Jur. St. 17). However, Shareholders was unable to cite any language in the *Hope* or *Bluefield* decisions to support this claim. Neither case contains any support for Shareholders' contention.

In the *Bluefield* case, *supra,* at page 692, this Court stated that as a measure of fairness and reasonableness a utility is entitled to earn a return ". . . equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and

uncertainties . . ." The *Hope* case, *supra* at page 602, makes clear that ". . . under the standard of 'just and reasonable' it is the result reached not the method employed which is controlling." A regulatory agency is not bound to the use of any formula or combination of formulas and may make the "pragmatic adjustments" that its regulatory duties may require. (*Id.* at page 602).

In determining a fair and reasonable rate of return, the Commission reviewed extensive statistical evidence and expert opinion testimony submitted by the Company, the Commission staff, and the Shareholders. (Decision No. 89316, Appx. at pp. 17b-18b). The Commission considered all of the parties' recommendations, and thereafter adopted a rate of return which in its judgment would provide reasonable earnings for Company's investors commensurate with returns on investments in other enterprises having similar risks. In addition to being consistent with *Hope* and *Bluefield,* the Commission's decision fully complies with the requirements established by the California Supreme Court. (See *City of Los Angeles v. Public Utilities Commission* (1972) 7 C.3d 331, 348.) Shareholders' attempts to show that its members' due process rights were violated amount to no more than dissatisfaction with a balancing process which weighs consumer, as well as investor, interests. Such dissatisfaction presents no federal question.

(2) The Commission Did Consider Inflation in Determining a Rate of Return

Shareholders argues that the Commission reached its decision on rate of return without considering the effect of attrition on Company's earnings. According to this argu-

ment, the Commission wholly ignored the impact of inflation on Company and its stockholders. Because of this alleged error, Shareholders contends that a rate of return was adopted which denied Company's stockholders their constitutional protection against confiscation. (Jur. St. 14, 17, 19).

Shareholders' assertion that the Commission ignored inflation is based on its selective reading of the Commission's decision. (See Jr. St. at pp. 11-12.) Contrary to Shareholders' belief, the Commission did not set a rate of return without considering inflationary pressures and subsequently decline to adjust the rate upward by a factor designed to counteract earnings attrition. Rather, the Commission considered a host of relevant factors, as it always does when, in a general rate case, it adopts a rate of return for a new test year. In adopting the rate of return, the Commission considered all of the available evidence regarding inflation and its effect on Company's earnings. The record shows that the rate of return adopted for Company was recommended by a Commission staff expert witness as being fair, reasonable, and including consideration of the inflationary pressures exerted upon ratepayers, the utility and investors in its securities. Moreover, the Commission took specific note of ". . . recent increases in inflation and upward trends in interest rates." (Decision No. 89316, Appx. at p. 20b).

Shareholders would have this Court require the Commission to recalculate the rate of return set for Company according to Shareholders' attrition allowance formula. However, the Commission in its own manner already has

recognized the impact of inflation on Company and made appropriate allowances in setting a rate of return. The fact that this rate is lower than what Shareholders would have adopted does not create a constitutional issue.

V

CONCLUSION

For the foregoing reasons, the appeal filed by Shareholders presents no question warranting review of the decision below, and should be denied.

Dated: November 16, 1979

Respectfully submitted,

JANICE E. KERR
HECTOR ANNINOS
ANNE K. MESTER
RANDOLPH L. WU
Attorneys for the Public Utilities Commission of the State of California

Supreme Court, U. S.
FILED
NOV 20 1979
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-628

CALIFORNIA ASSOCIATION OF UTILITY SHAREHOLDERS (a corporation),

Appellant,

v.

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA AND JOHN E. BRYSON, VERNON L. STURGEON, RICHARD D. GRAVELLE, CLAIRE T. DEDRICK, and LEONARD M. GRIMES, JR., the members of said Public Utilities Commission; THE PACIFIC GAS AND ELECTRIC COMPANY, a corporation,

Appellees.

On Appeal From the Supreme Court of the State of California

APPELLANT'S BRIEF OPPOSING COMMISSION'S MOTION TO DISMISS

WILLIAM L. KNECHT
524 - 23rd Street
Oakland, California 94612

HOWARD C. ANDERSON
Dewey, Ballantine, Bushby,
Palmer & Wood
1775 Pennsylvania Avenue, N.W.
Washington, D.C. 20006
(202) 862-1050

Attorneys for Appellant
California Association of
Utility Shareholders

November 20, 1979

PRESS OF BYRON S. ADAMS PRINTING, INC., WASHINGTON, D. C.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-628

CALIFORNIA ASSOCIATION OF UTILITY SHAREHOLDERS
(a corporation),

Appellant,

v.

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA AND JOHN E. BRYSON, VERNON L. STURGEON, RICHARD D. GRAVELLE, CLAIRE T. DEDRICK, and LEONARD M. GRIMES, JR., the members of said Public Utilities Commission; THE PACIFIC GAS AND ELECTRIC COMPANY, a corporation,

Appellees.

On Appeal From the Supreme Court of the State of California

APPELLANT'S BRIEF OPPOSING COMMISSION'S MOTION TO DISMISS

Contrary to the argument made by the Commission, the Shareholders do not contend that the Commission ignored the impact of inflation. Of course today's prices reflect past inflation. What the Shareholders contend is that the Commission ignored attrition, that is the demonstrated continuing change in the relationship be-

tween the Company's investment and net earnings. That the Commission ignored attrition is confirmed by the Commission's Motion to Dismiss. There is nothing in that document which even indicates an awareness of what attrition is, let alone anything which implies that the Commission dealt with it in any way.

The legislative act of fixing rates for the future is supported by a yardstick which is familiar to this Court, namely, the test year ratio between net earnings and net investment. The Commission picked 12.83% on equity as a rate of return. The Commission ignored the fact that it used a rubber yardstick, since *any* rate of return decays at the rate of 0.16% per month. The Shareholders' evidence regarding attrition was unchallenged and uncontradicted. The right of the Shareholders to fair treatment, guaranteed by the Constitution and by this Court, has been destroyed by the use of figures which do not take account of the changing yardstick. The fact that the Commission says nothing about it in its 107 page opinion, that the Supreme Court of California says nothing about it, and that, in addressing this Court, Commission's counsel say nothing about it, adds insult to injury. The Commission does not bother to discuss this violation of constitutional rights.

The Shareholders' evidence involved continuing inflation at the rate of 6% per annum. In fact, raging inflation has proceeded at twice that rate. The Company has never, since 1973, earned the rate of return "allowed" by the Commission. The Shareholders' equity is confiscated; California law requires the Company to sell new stock, below book value, expropriating equity step by step. The October, 1979, sale of common stock increased to $350 million (from $279 million; Jurisdictional Statement, page 9) the confiscation of common

equity. The market to book ratio of the Company's common stock is 75% (October 31 price, June 30 book value, from Salomon Brothers' "Electric Utility Common Stock Data", dated November 2, 1979). For the 100 leading utilities the market to book ratio was 79%. Typical California utilities as of the same date: Southern California Edison, 72%; San Diego Gas & Electric, 78%.

The 12.83% rate of return on equity is too low, yet *on this appeal* the Shareholders' argument is not that it cannot be derived from the fictitious test year data. Shareholders contend that this rate of return (or *any* rate of return) is a hoax, and violates constitutional rights, when it does not take account of the fact that the inputs are changing.

The electric and gas utilities are of vital importance as our energy problems grow. Our entire economy rests on them. Their ability to serve is being destroyed, nationwide, by regulation which violates the decisions of this Court. This is a critical national problem.

The failure to adjust the rubber yardstick (which failure is admitted by the Commission's submission to this Court) means that the tests of *Hope* and *Bluefield** are violated: the fictitious rate of return does not attract capital on reasonable terms and does not assure (in fact, it destroys) the financial integrity of the utilities. The Commission does not bother to deny this. The market to book ratios are engraved on the tombstones of the utilities, and the Commission ignores them. The Commission invokes the "result reached"

---

* *F.P.C.* v. *Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944); *Bluefield Water Works & Improvement Co.* v. *Public Service Commission of West Virginia*, 262 U.S. 679, 693 (1923).

language of *Hope* (Commission's Motion, p. 5). The fact is that the result reached is horrible: PG&E equity holders are being destroyed, and the Commission necessarily admits the repeated, state-compelled sale of stock below book, using locked-in capital as bait to be sold cheap to new investors. On the "result reached" standard, the Commission is shown as completely indifferent to the decisions of this Court and the constitutional rights of Shareholders.

The appropriate remedy is for this Court to reverse and remand, with instructions to take account of attrition and to make a *bona fide* determination of a proper allowance.

The Court should deny the Motion to Dismiss and note probable jurisdiction of this appeal.

Respectfully submitted,

WILLIAM L. KNECHT
524 - 23rd Street
Oakland, California 94612

HOWARD C. ANDERSON
Dewey, Ballantine, Bushby,
Palmer & Wood
1775 Pennsylvania Avenue, N.W.
Washington, D.C. 20006
(202) 862-1050

Attorneys for Appellant
California Association of
Utility Shareholders

November 20, 1979